83-738

No.________________

IN THE

Supreme Court of the United States

October Term, 1983

NEW YORK STATE DEPARTMENT OF
PUBLIC SERVICE,

Appellant,

vs.

UNITED STATES OF AMERICA, AMERICAN TELEPHONE
AND TELEGRAPH COMPANY, *et al.*,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

JURISDICTIONAL STATEMENT

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Question Presented

Whether the plan of reorganization of American Telephone and Telegraph Company (AT&T) violates the Decree by allowing AT&T to retain customer premises equipment while transferring the enormous costs of installing and testing this equipment to the newly divested Bell Operating Companies?

Parties Below

In addition to the United States, American Telephone & Telegraph Company ("AT&T"), Western Electric Company, Inc., and Bell Laboratories, Inc., the following parties were admitted as intervenors by District Court order entered August 26, 1982 (J.A. 191-194): *Ad Hoc* Telecommunications Users Committee; American Newspaper Publishers Association; American Petroleum Institute; American Satellite Company; Associated Telephone Answering Exchanges, Inc.; Association of American Railroads; Association of Data Communications Users; Association of Data Processing Service Organizations; Audichron Company; Black Citizens for a Fair Media; California Hispanics; Citizens Utilities Company; Communication Commission of the National Council of the Churches of Christ in the USA; Communications Workers of America; Compuserve, Inc.; Computer and Business Equipment Manufacturers Association; Computer and Communications Industry Association; Congress Watch; Continental Telecom, Inc.; D/FW Signal, Inc.; Education and Cultivation Division of the General Board of Global Ministries of the United Methodist Church; Federal Communications Commission; General Dynamics Communications Co.; General Telephone & Electronics Corp.; Independent Data Communications Suppliers' Council; International Telephone and Telegraph Corp.; Jack Faucett Associates, Inc., *et al.*; Leghorn Telepublishing Co.; MCI Communications Corp.; Mobile Marine Radio, Inc.; National Association for the Advancement of Colored People; National Association for Better Broadcasting; National Association of Broadcasters; National Association of Regulatory Utility Commissioners; National Association of State Utility Consumer Advocates; National Cable Television Association; National Catholic Broadcasters Association; National Citizens Committee for Broadcasting; National Latino

Media Coalition; National Newspaper Association; North American Telephone Association; Northeastern Telephone Co.; Office of Communication of the United Church of Christ; Reformed Church in America; Rogers Radio Communication Services, Inc.; Rural Telephone Coalition; San/Bar Corp.; Satellite Business Systems; Sonitrol Distributors Council, Inc.; Southern Pacific Communications Company; Sperry Corporation; Stromberg-Carlson Corp.; Tandy Corporation; Telocator Network of America; U.S. Telephone Communications, Inc.; United States Independent Telephone Association; United States Telecommunications Suppliers Association; United Telecommunications, Inc.; Utilities Telecommunications Council; Warner Amex Cable Communications, Inc.; Western Union Telegraph Co.; Westinghouse Broadcasting and Cable, Inc.; Alarm Industry Telecommunications Committee; States of Arizona, California, Colorado, Delaware, Illinois, Maine, Maryland, Michigan, Missouri, New Hampshire, New Mexico, New York, North Carolina, Oregon, Pennsylvania, Tennessee, Virginia, Wisconsin; Alabama Public Service Commission; Arkansas Public Service Commission; California Public Utilities Commission; District of Columbia Public Service Commission; Florida Public Service Commission; Idaho Public Utilities Commission; Kentucky Public Commission; Michigan Public Service Commission; Missouri Public Service Commission; Montana Public Service Commission; Nebraska Service Utilities Commission; Nevada Public Service Commission; New York State Department of Public Service; South Dakota Public Utilities Commission; Utah Public Service Commission; Public Service Commission of West Virginia; Wisconsin Public Service Commission; Wyoming Public Service Commission; Iowa Commerce Commission; Kansas Corporation Commission; New Mexico Corporation Commission; Virginia State Corporation Commission; Washington Utilities & Transportation Commission; City of Cincinnati; and the City of New York.

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UNITED STATES OF AMERICA, AMERICAN
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COMPANY, *et al.,*

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

JURISDICTIONAL STATEMENT

Appellant, New York State Department of Public Service (hereinafter NYS DPS), respectfully requests that this Court note probable jurisdiction of its appeal from the District Court's opinion filed July 8, 1983; its memorandum filed July 28, 1983; and its memorandum and order filed August 5, 1983 approving AT&T's plan of reorganization, as modified. The appeal has been

certified to this Court, pursuant to the Expediting Act (15 U.S.C. §29[b]), by District Court order filed September 7, 1983.

Opinions Below

The opinion of the District Court filed August 11, 1982 (J.A. 1-172)[1], and the modification of final judgment filed August 24, 1982 (J.A. 173-190), are officially reported as *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd. mem. sub nom. Maryland v. United States*, _____ U.S. _____, 75 L. Ed. 2d 472, 103 S. Ct. 1240 (1983).

The District Court's opinion of July 8, 1983 (J.A. 195-330), not yet officially reported, is published at Trade Reg. Rep. (CCH), Rpt. No. 604 (extra ed. July 19, 1983). The District Court's memorandum of July 28, 1983 (J.A. 331-340) is neither officially nor unofficially reported. The District Court's memorandum and order of August 5, 1983 (J.A. 341-350), not yet officially reported, are published at 1983-2 Trade Cas. (CCH) ¶65, 536. The District Court's order of September 7, 1983 (J.A. 351-354), not yet officially reported, is published at 1983-2 Trade Cas. (CCH) ¶65, 596.

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[1] References to "J.A." are to the Joint Appendix to the Jurisdictional Statements filed herewith by the New York State Department of Public Service and the People of the State of California and the Public Utilities Commission of the State of California.

Jurisdiction

On August 24, 1982, the District Court entered a modification of final judgment ("MFJ") in a civil antitrust action initiated by the Department of Justice against AT&T. This Court affirmed the entry of the MFJ. *United States v. AT&T*, 552 F. Supp. 131 (D.D.C. 1982), *aff'd. mem. sub nom. Maryland v. United States*, _____ U.S. _____, 75 L. Ed. 2d 472, 103 S. Ct. 1240 (1983).

Pursuant to the terms of the MFJ, AT&T thereafter filed a plan of reorganization setting forth the manner in which it proposed to implement the provisions of the decree. The District Court conducted proceedings under the Antitrust Procedures and Penalties Act, 15 U.S.C. §16 to ascertain whether the plan was consistent with the principles and provisions of the MFJ and otherwise in the "public interest." By the District Court's opinion filed July 8, 1983; its memorandum filed July 28, 1983; and its memorandum and order entered August 5, 1983, the District Court rejected the arguments set forth here and approved AT&T's plan of reorganization, as modified. The District Court's August 5, 1983 order, approving the plan as "consistent with the provisions and principles" of the MFJ (J.A. 350), is a final order for purposes of appeal.

On September 13, 1983, the New York State Department of Public Service ("NYS DPS") filed a timely notice of appeal from such order. On September 7, 1983, the District Court had granted the motion of the Department of Justice to certify another appeal from the District Court's August 5, 1983 order[2] to this Court

[2] The People of the State of California and the Public Utilities Commission of the State of California filed a notice of appeal from the District Court's August 5, 1983 order on August 10, 1983 (J.A. 355-356).

pursuant to the Expediting Act (J.A. 351-354). The District Court's certification order to this Court is applicable to the instant appeal (J.A. 352).

Statutory Provisions

The text of 15 U.S.C. §§16 and 29 is set forth at J.A. 359-364.

Statement of the Case

On August 24, 1982, following "public interest" proceedings held pursuant to the Tunney Act (15 U.S.C. §16), the District Court entered a "modification of final judgment" (hereinafter "MFJ" or "decree") which settled certain civil antitrust litigation between the Department of Justice and AT&T (J.A. 173-190). The MFJ set forth the general principles and guidelines under which a fundamental restructuring of the Bell System was to take place. As it pertains to the subject matter of this appeal, the decree required the 22 local Bell Operating Companies (BOCs) to transfer their in-place customer premises equipment (CPE) base to AT&T. That is, the MFJ required the BOCs to separate and transfer to AT&T:

> *All* facilities, personnel, and books of account . . . *relating to . . . the provision of customer premises equipment to the public.* (MFJ, Section I[A][2]; J.A. 174) (emphasis added).

Pursuant to section I[A] of the MFJ (J.A. 174), AT&T was required to file a plan of reorganization setting forth the specific manner and means by which it proposed to implement the decree's reorganization of the Bell System. District Court approval of this plan of reorganization, "as being consistent with the provisions

and principles of the decree," was required before the reorganization could proceed (MFJ, §VIII[J]; J.A. 185).

In December of 1982, AT&T filed its plan. Pursuant to the terms of the MFJ, it properly assigned the actual customer premises equipment to AT&T.[3] The plan failed, however, to provide for the transfer of certain CPE-related costs (referred to as "station handling costs") to AT&T. These expenses, booked in Account 232 of the Uniform System of Accounts, are capitalized labor costs incurred in the handling, installation, and testing of the CPE to be transferred to AT&T. Station handling costs are the subject matter of this appeal.

NYS DPS objected to AT&T's proposal to assign these CPE-related costs to the post-divestiture BOCs. We contended that these costs were *indisputedly* incurred "in the provision of customer premises equipment to the public" and were thus assignable to AT&T under Section I[A][2] of the decree. In response, AT&T argued that although station handling costs related to customer premises equipment, they could not be quantified and thus could not be transferred to AT&T.

Both NYS DPS and the Public Utilities Commission of the State of California subsequently demonstrated that station handling costs could be identified in a reasonably accurate manner. In fact, NYS DPS pointed out that New York Telephone had recently presented a detailed analysis and breakdown of Account 232 and had segregated station handling costs.

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[3] Most of the BOCs' investment in actual CPE is accounted for in Accounts 231 ("Station Apparatus") and 234 ("Large Private Branch Exchanges") of the Uniform System of Accounts. The plan assigned these two accounts to AT&T.

By opinion filed July 8, 1983 (J.A. 195-330), the District Court stated that it would approve the plan of reorganization, provided that AT&T made certain modifications (not relevant here) to its plan. The Court did not discuss the issue of Account 232 "station handling" costs. Thereafter, upon the filing of several motions for reconsideration, the Court issued a memorandum opinion which, *inter alia*, addressed and rejected the argument that station handling costs should be transferred to AT&T (J.A. 341-348). Specifically, the Court stated:

> Account 232 also includes the capitalized labor costs associated with the installation and testing of customer premises equipment, and a theoretical case could be made that, since under the plan embedded CPE is being transferred to AT&T so should be this portion of Account 232. However, the court was and is persuaded by AT&T's argument, for the reasons stated in AT&T's Response to Objections at 154-155, that there is no practical way to separate out the various handling costs (J.A. 344).

It is respectfully submitted that the District Court's ruling on this issue was predicated on a fundamental mistake of fact and otherwise not in the public interest. Station handling costs *can* be identified with as much certainty as a myriad of other assets and costs being transferred in the divestiture proceeding.

The Question is Substantial

The question concerning the proper disposition of station handling costs is indeed "substantial." The station handling costs associated with the customer premises equipment which AT&T will retain are *at least* $106 million and possibly as high as $600 million in New York State alone.[4] Assigning these costs, without the equipment they are associated with, to New York Telephone places that company in the untenable position of either writing them off or seeking to convince state regulators that they should be borne by local exchange customers. In short, the question under review directly impacts on the future viability of the new operating companies, which will serve 80% of this country's telephone subscribers.

The resolution of this question will also have a substantial impact on the competitive environment of the customer premises equipment marketplace. CPE vendors other than AT&T will have to reflect the costs of ordering, installing, and testing their equipment in their prices. If AT&T is successful in its plan to assign its own station handling costs to the new operating companies, it will enter the CPE marketplace with an unwarranted competitive advantage. Such circumstances are neither consistent with the principles and provisions of the MFJ nor the public interest.

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[4] New York Telephone, NY PSC Case 28446, has quantified station handling costs at $106,442,000. However, its figure gives no recognition to the $487,882,000 Account 232 residual.

Although the *precise* quantification of station handling costs involve some judgment, the point is that the costs are *at least* $106,442,000 in New York alone. There is no basis for simply ignoring *these* costs and providing AT&T with a windfall.

Finally, NYS DPS wishes to emphasize that the Court's plenary consideration of the issue raised herein (with full briefs on the merits and oral argument) would *not* delay the AT&T divestiture schedule for January 1, 1984. Irrespective of when the Court adjudicates this appeal, the reorganization of the Bell System will go forward. If the Court finds after January 1, 1984 that station handling costs should have been retained by AT&T, it can direct the District Court[5] (with the assistance of the parties) to arrive at a reasonable estimate of these costs. AT&T could then be directed to assume a corresponding portion of the operating companies' debt and equity.

Conclusion

Based on the foregoing reasons, the Court should note probable jurisdiction of this appeal.

Respectfully submitted,

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[5] Pursuant to Section VIII[I] of the MFJ, the District Court has retained continuing jurisdiction "for the construction or carrying out of this decree [and] for the enforcement of compliance therewith." (J.A. 185).

SEE COMPANION CASE

Nos. 83-737 and 83-738

In the Supreme Court of the United States

OCTOBER TERM, 1983

PEOPLE OF THE STATE OF CALIFORNIA, ET AL.,
APPELLANTS

v.

UNITED STATES OF AMERICA, ET AL.

NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE,
APPELLANT

v.

UNITED STATES OF AMERICA, ET AL.

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

MOTION TO AFFIRM

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QUESTION PRESENTED

Whether the district court abused its discretion in approving, as consistent with the provisions and principles of the modified consent decree, the plan of reorganization agreed to by AT&T and the government, which specifies in greater detail how that consent decree is to be implemented.

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UNITED STATES OF AMERICA, ET AL.

ON APPEALS FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

MOTION TO AFFIRM

OPINIONS BELOW

The August 11, 1982, opinion of the district court (J.S. App. 1-172) and the modification of final judgment (J.S. App. 173-190) filed August 24, 1982, are officially reported as *United States* v. *AT&T*, 552 F. Supp. 131 aff'd mem. *sub nom. Maryland* v. *United States*, No. 82-952 (Feb. 28, 1983).

The July 8, 1983, opinion of the district court stating that it would approve the plan of reorganization only if

modified in certain respects (J.S. App. 195-330) is reported at 569 F. Supp. 1057-1124. The July 28 and August 5, 1983, memoranda of the district court clarifying and denying reconsideration of the July 8 opinion (J.S. App. 331-340, 341-348) are reported at 569 F. Supp. 1124-1131. The order entered August 5, 1983, approving the plan of reorganization as amended (J.S. App. 349-350) is reported at 569 F. Supp. 1131. The September 7, 1983 order of the district court granting certification to this Court under 15 U.S.C. 29(b) (J.S. App. 351-354) is not yet reported.

JURISDICTION

The order approving the plan of reorganization was entered on August 5, 1983 (J.S. App. 349-350). The notice of appeal of the People of the State of California and the Public Utilities Commission of the State of California was filed on August 10, 1983 (J.S. App. 355-356). On September 7, 1983, the district court certified that the direct consideration by this Court of all appeals in this case is of general public importance in the administration of justice (J.S. App. 351-354). On September 13, 1983, the New York State Department of Public Service filed a notice of appeal (J.S. App. 357-358). The appeals were docketed in this Court on November 2 and 3, 1983. The jurisdiction of this Court is invoked under 15 U.S.C. 29(b).

STATEMENT

1. On January 8, 1982, the government and the American Telephone & Telegraph Company (AT&T) announced the dismissal of the government's pending antitrust case against the company.[1] Concurrently,

[1] The government sued AT&T in 1974, claiming that AT&T had used its monopoly power in local exchange telephone service to exclude competition in the telecommunications equipment and intercity services markets, in violation of Section 2 of the Sherman Act, 15 U.S.C. 2. *United States* v. *American Tele-*

they announced a proposed modification of a 1956 consent decree entered in an earlier suit[2] which provided all of the relief sought by the government in the 1974 litigation. Specifically, it provided for the separation of the Bell operating companies, which provide local telephone services, from the remainder of the AT&T system. J.S. App. 174-175. This separation would eliminate AT&T's ability to continue the anticompetitive practices alleged in both cases by preventing AT&T from employing monopoly power in local exchange services to disable competition in other, potentially competitive markets.[3] The decree further required that, not

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phone & Telegraph Co., Civ. No. 74-1698 (D.D.C. filed Nov. 20, 1974). In particular, the complaint alleged that AT&T had monopolized customer premises equipment (CPE) by discriminating against competitors' equipment, had monopolized telecommunications equipment used by the Bell operating companies (BOCs) through various preferential devices, and had monopolized intercity telecommunications through discriminatory terms imposed upon and discriminatory refusals to interconnect with other companies. At trial, the government sought the divestiture of those parts of the BOCs that provide local exchange services, or, alternatively, divestiture of Western Electric.

[2] In 1949, the United States sued Western Electric Company, Inc., and its parent, AT&T, claiming that they had monopolized and conspired to restrain trade in the manufacture and distribution of telephone equipment, in violation of Sections 1 and 2 of the Sherman Act, 15 U.S.C. 1 and 2. *United States* v. *Western Electric Co.*, Civ. No. 17-49 (D.N.J. filed Jan. 14, 1949).

[3] The 1956 consent decree prohibited AT&T and the BOCs from engaging "in any business other than the furnishing of common carrier communications services," defined as "services and facilities * * * the charges for which are subject to public regulation under the Communications Act of 1934" or under state law. See J.S. App. 7, 81 n. 196. The decree also required the licensing of Bell System patents to all applicants at reasonable royalties. *Id.* at 7, 77. Because the new structural relief provided by the modified decree renders these restraints unnecessary, the decree frees AT&T from these restrictions. See generally *id.* at 57-58, 66-67.

later than six months after its effective date, AT&T submit to the Department of Justice for its approval a plan of reorganization to implement the decree, such plan to be effective not later than 18 months after the date of the decree. *Id.* at 174.

On August 11, 1982, following extensive comments, briefing and argument by interested parties,[4] the district court issued a lengthy opinion in which it found that most of the provisions of the proposed modified decree, including the basic provision for AT&T's divestiture of the BOCs' local exchange monopolies, were in the public interest (J.S. App. 1-172).[5] The district court stated, however, that it would approve the decree only if the parties agreed to several substantive and procedural amendments to the proposed decree (*id.* at 170-172). Among these was a provision specifying that the plan of reorganization to be prepared by AT&T and approved by the Department of Justice would "not be implemented until approved by the [district c]ourt as being consistent with the provisions and principles of the decree" (*id.* at 156, 172). The government and

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[4] The United States published notice of the proposed settlement and a competitive impact statement in the Federal Register. 47 Fed. Reg. 7170-7184 (1982). The district court received more than 600 comments on the proposed modified decree and numerous briefs on several issues from more than 100 organizations. See J.S. App. 22-25. It also heard oral argument at which 20 counsel from 18 organizations participated (*id.* at 25 & n.65).

[5] Over the objections of several states and state regulatory agencies, the court held that, in order to effectuate the decree's goal of eliminating the effects of past anticompetitive conduct in interstate communications, it could order AT&T to take actions, such as reorganizing and separating assets and common carrier responsibilities, without obtaining prior approval of such actions from state regulatory agencies (J.S. App. 36-48). The court also approved releasing AT&T from most of the line-of-business restrictions and patent licensing requirements imposed by the 1956 decree (*id.* at 77-79).

AT&T thereafter agreed to the court's proposed changes, and on August 24, 1982, the court entered the decree as a modification of the 1956 final judgment in the *Western Electric* case (*id.* at 173-190).[6]

2. The district court allowed numerous states, state regulatory agencies, and private parties to intervene in the proceedings (J.S. App. 191-194), and several of these intervenors noticed appeals from the judgment. On November 10, 1982, the district court, pursuant to the Expediting Act, 15 U.S.C. 29(b), certified the appeals for immediate review by this Court, finding that "immediate consideration of the appeal by the Supreme Court is of general public importance in the administration of justice." See J.S. App. 352-353. As requested by the United States and AT&T, this Court accepted jurisdiction of the appeals and summarily affirmed the decree. *Maryland* v. *United States*, No. 82-952 (Feb. 28, 1983).

3. On December 16, 1982, AT&T submitted a proposed plan of reorganization to the Department of Justice. The Department carefully reviewed the 471-page plan and discussed it with state regulatory officials, other carriers, providers of telecommunications equipment, officials of AT&T and the BOCs, and others. U.S. Resp. at 14-20.[7] As a result of its review, the Department required AT&T to make various modifications and, as modified, the plan was submitted to the district court. J.S. App. 195-196. The court thereafter received comments and briefs filed by intervenors and other interested persons, considered the replies of AT&T and

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[6] Because this decree provided all the relief sought in the 1974 litigation, the court accepted a stipulated dismissal of that case.

[7] "U.S. Resp." refers to the Response of the United States to Public Comments and Action on AT&T's Proposed Plan of Reorganization, filed in the district court on March 24, 1983.

the Department of Justice, and heard oral argument on certain issues. *Id.* at 196-197, 323.

On July 8, 1983, the district court issued a lengthy opinion (J.S. App. 195-330) discussing the proposed plan. The court found that most of the provisions of the plan, including the basic plan for division of assets between AT&T and its subsidiaries and for the eventual provision by the BOCs of equal exchange access for all interexchange carriers, were consistent with the provisions and principles of the decree (*id.* at 197). The district court stated, however, that it would require certain modifications in the plan before approving it (*id.* at 197, 328-330). Following AT&T's and the government's consent to these modifications, the court, on August 5, 1983, entered an order approving the plan as modified (*id.* at 349-350).

4. On August 10, 1983, the People of the State of California and the Public Service Commission of the State of California filed a notice of appeal from the order aproving the plan (J.S. App. 355-356). On August 25, 1983, the United States, supported by AT&T, asked the district court to certify the California appeal and any other appeals for direct review by this Court pursuant to the Expediting Act. No party opposed that request.

On September 7, 1983, the district court certified the appeals, finding that the considerations that had supported direct Supreme Court review of the appeals from the entry of the decree were equally applicable to review of the order approving the plan (J.S. App. 351-354). The court concluded that "[e]ven though it is not likely that the appeals will present questions of legal significance, they are clearly of general public importance" (*id.* at 352) (footnote omitted) because AT&T's divestiture of the BOCs, "apparently the largest corporate reorganization in history, will directly affect millions of employees and shareholders, the na-

tion's telephone subscribers, AT&T's competitors, the telecommunications industry in general, and the responsibilities of federal and state regulatory bodies" (*id.* at 353). Moreover, the district court noted, given the rapidly approaching January 1, 1984, divestiture date, "a speedy, final resolution of the legal situation is all the more necessary" to protect the public interest as well as "the various private interests involved" in the divestiture (*ibid.*). Accordingly, since "[i]t is unlikely that such a resolution could be secured through the normal process of review by the U.S. Court of Appeals to be followed by a petition for writ of certiorari to the Supreme Court" (*ibid.*), the district court certified that "immediate consideration * * * of the appeal and of any additional appeals filed hereafter is of general public importance in the administration of justice" (*id.* at 354) (footnote omitted).[8]

ARGUMENT

Last Term, this Court summarily affirmed the modified consent decree entered by the district court in this case. Thus, the Court is familiar with the provisions and principles of the decree and is well aware that its prompt implementation is "of general public importance in the administration of justice" (15 U.S.C. 29(b)). The plan of reorganization, which is the subject of the present appeals, actuates the provisions of the decree, and the policies that justified expedited review last Term are fully applicable here. Moreover, as in the earlier appeal, the issues now before the Court do not warrant

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[8] The New York State Department of Public Service subsequently filed a notice of appeal on September 13, 1983. J.S. App. 357-358. No other party has appealed.

All appeals from the order approving the plan must be taken directly to this Court; the court of appeals has no jurisdiction absent a remand pursuant to 15 U.S.C. 29(b)(2). *United States v. Western Electric Co.*, 714 F.2d 178 (D.C. Cir. 1983).

plenary consideration. Accordingly, the United States, pursuant to the Expediting Act, 15 U.S.C. 29(b), and Rule 16.1 of the Rules of this Court, moves for summary affirmance.

I. THE COURT SHOULD ACCEPT THE DIRECT APPEALS

The appropriateness of direct review under the Expediting Act, 15 U.S.C. 29(b), turns on the importance of a prompt decision of a case in view of its economic significance, not on the difficulty or general significance of the legal issues presented. The Act expressly refers to the importance of "immediate consideration of the appeal" and makes no mention of the significance of the issues raised.[9] Similarly, the focus of the legislative history of the Expediting Act[10] is not on the importance of the issues raised to the development of the law, but rather on the immediate economic impact of the case itself.[11] While Congress, of course, did not regard every

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[9] Prior to 1974, the Expediting Act, ch. 544, 32 Stat. 823 *et seq.*, provided for direct review by this Court in all government civil antitrust suits. The Act was amended to its present form in 1974 to relieve this Court of that burden. See S. Rep. 93-298, 93d Cong., 1st Sess. 6 (1973). In amending the statute, however, Congress recognized that occasionally there would be antitrust cases for which the public interest required an avenue of direct appeal to this Court. Accordingly, Congress preserved a limited right of direct appeal under 15 U.S.C. 29(b).

[10] See generally S. Rep. 93-298, 93d Cong., 1st Sess. 7-8 (1973); H.R. Rep. 93-1463, 93d Cong., 2d Sess. 10-11 (1974); 119 Cong. Rec. 24599 (1973); 120 Cong. Rec. 38585-38587, 39123 (1974).

[11] As the House Judiciary Committee noted in its report on this provision, "public antitrust cases are unlike other federal cases, * * * they have an impact on the economic welfare of this nation, and * * * consequently they should be treated accordingly." H.R. Rep. 93-1463, 93d Cong., 2d Sess. 14 (1974). See also S. Rep. 93-298, 93d Cong., 1st Sess. 3-4 (1973); 119 Cong. Rec. 24599 (1973).

government civil antitrust suit as being sufficiently important to merit direct review, it did establish a mechanism by which antitrust cases with the most significant economic impact on the public interest could be appealed directly to this Court. This case satisfies that admittedly high standard.

A. The consent decree in this case provides an effective structural remedy that will further the public interest in competition and remedy past competitive restraints in the vitally important national telecommunications industry. As the district court and this Court recognized, direct review of the decree was necessary to minimize delay in the development of the plan of reorganization and uncertainty as to when—and, indeed, whether—the actions required by the decree would occur. Such delay or uncertainty would have been harmful not only to AT&T, its employees, shareholders, and customers, but also to other firms in the telecommunications and related industries, whose business plans depend on the divestiture schedule. Most importantly, delay would have been harmful to the public interest in speedily ending restraints on competition and establishing a restructured, competitive telecommunications industry.[12] It was for these reasons that the district court certified and this Court accepted expedited consideration of the decree.

B. The plan of reorganization approved by the district court is the essential blueprint for implementation of the decree. Accordingly, the district court correctly concluded (J.S. App. 352) that the same considerations that made expedited review of the decree appropriate are equally applicable to appeals calling into question the validity of the plan; progress toward implementa-

[12] Expedited direct review of the decree also served to minimize the risk that states would obtain court orders conflicting with or enjoining actions essential to the decree's implementation.

tion of the decree has not lessened the significance of this case. As the district court emphasized in certifying these appeals (*id.* at 353), the plan implements the divestiture mandated by the decree, which is "the largest corporate reorganization in history [and which] will directly affect millions of employees and shareholders, the nation's telephone subscribers, AT&T's competitors, the telecommunications industry in general, and the responsibilities of federal and state regulatory bodies." Since "the various public and private bodies are currently implementing detailed plans to effectuate the reorganization" on the January 1, 1984, date prescribed in the plan, "[u]ncertainty regarding the legal status of [the] reorganization would have serious adverse consequences" for all the diverse interests involved (*ibid.)* (footnote omitted)—adverse consequences that can be avoided by a final ruling by this Court. Such review must be expedited because it is even more clear than it was a year ago that the normal process of appellate review will not permit such a ruling before January 1, 1984, the date of implementation of the plan.[13]

C. Direct review is particularly appropriate in this case in light of the nature of the issues raised by appellants. They have challenged provisions of the plan which, as AT&T explains (Mot. to Aff. 11), have significant financial implications for AT&T, the BOCs, and various regulatory authorities. As a result, the mere pendency of the appeals—despite their lack of merit—creates uncertainty not only for BOC and AT&T managements, but also for the regulators and the millions of investors, potential investors, creditors and ratepayers affected by this case. This Court, having previously re-

[13] Even if this Court is unable to rule before January 1, 1984, an expedited decision in this Court will better serve the public interest in the prompt resolution of this case than would a remand to the court of appeals, as suggested by appellants (Cal. J.S. 21).

viewed the decree, is familiar with its provisions and principles. Consequently, direct review of the meritless issues raised by California and the New York Department of Public Service should not be unduly burdensome for the Court, particularly when weighed against the public benefit that will result from an expeditious resolution of this exceedingly important case.

II. THE COURT SHOULD SUMMARILY AFFIRM THE JUDGMENT OF THE DISTRICT COURT

The appellants' claims that certain aspects of the plan of reorganization are inconsistent with the modified consent decree are insubstantial and do not warrant plenary consideration.

A. The District Court's Judgment Must Be Affirmed Unless There Has Been A Clear Abuse of Discretion

This Court has affirmed the modified consent decree itself, and appellants cannot and do not challenge the decree's provisions. The government and AT&T, moreover, agree that the plan is consistent with the obligations imposed on AT&T by the decree. Thus, were this a normal case, there would be no need for judicial intervention.[14] But, because of the complexity and importance of this case, the district court insisted that the plan "not be implemented until approved by the [district c]ourt as being consistent with the provisions and principles of the decree" (J.S. App. 152-156, 169-170, 172). The district court has approved the plan, and its determination, contested by appellants, should be given substantial deference by this Court.

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[14] A consent decree has attributes of both a contract and a judicial act (*United States* v. *ITT Continental Baking Co.*, 420 U.S. 223, 236 n.10 (1975)), but it "is to be construed for enforcement purposes basically as a contract" (*id.* at 238). Accord, *United States* v. *Armour & Co.*, 402 U.S. 673 (1971). Like any other contract, a consent decree is properly viewed as an embodiment of the intent of the parties.

The district court found the plan to be consistent with the provisions and principles of the modified consent decree after careful consideration of the extensive submissions by the parties and intervenors.[15] The officials of the newly created regional operating companies, furthermore, represented to the court that the plan (amended as required by the government and the district court) will enable them to be economically and functionally viable, and the vast majority of the intervenors, notwithstanding their diverse interests, now appear willing to accept the plan. Significantly, there is no dispute between the parties to the decree as to its meaning. In these circumstances, deference to the district court's conclusion that the plan is consistent with the decree is peculiarly appropriate and, absent a showing that the district court clearly abused its discretion,[16] the district court's judgment should be affirmed.

B. The Plan's Allocation of Account 232 Assets Is Consistent with the Decree

The central purpose of the modified consent decree is to prevent the recurrence of the anticompetitive conduct alleged in this litigation by separating those parts of the Bell operating companies that provide exchange telecommunications and exchange access services, which presently constitute a series of monopoly markets, from the rest of the Bell System. Thus, the decree

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[15] In the exercise of its oversight function, the district court, which had carefully scrutinized the decree itself, received and considered over 50 sets of comments on the plan from interested persons as well as the responses of the Department of Justice and AT&T, and the statements of officials of the new regional BOCs. See J.S. App. 195-197, 323.

[16] Clear abuse of discretion is the appropriate standard for appellate review of a district court's determination that a consent decree is in the public interest. See, *e.g.*, *Cranston* v. *Hardin*, 504 F.2d 566, 577 (2d Cir. 1974); *City of Detroit* v. *Grinnell Corp.*, 495 F.2d 448, 454-455 (2d Cir. 1974).

provides that the divested BOCs will retain "all facilities, personnel and books of account * * * relating to the exchange telecommunications or exchange access functions" (as defined in the decree) (J.S. App. 174). In addition, the BOCs will receive from AT&T and its affiliates "sufficient facilities, personnel, systems, and rights to technical information" to permit the BOCs to perform those functions independently of AT&T (*ibid.*). AT&T is to retain those "facilities, personnel and books of account * * * relating to other functions (including the provision of interexchange switching and transmission and the provision of customer premises equipment to the public)" (*ibid.*).[17]

Dividing over $150 billion in Bell System assets and corresponding liabilities according to these principles is obviously a complex task. While the government, the district court and most interested persons have concluded that the plan will accomplish this task in a manner consistent with the decree, California and the New York Department of Public Service would each prefer a slightly different allocation of assets. The changes in the plan that each of these appellants advocates would appear to benefit its own local ratepayers over other users of or investors in the national telecommunications system. But that obviously is not a purpose of the decree, and neither appellant can show any abuse of discretion in the district court's approval of the plan.

One category of assets assigned to the BOCs under the plan consists of all assets included in Account 232 of the Federal Communications Commission's Uniform System of Accounts. The Commission defines Account 232 to include "the original cost of installing or connecting items of station apparatus and the original cost of inside wiring and cabling and of drop and block

[17] The decree allows the BOCs to provide, but not to manufacture, CPE (J.S. App. 183).

wires." 47 C.F.R. 31.232(a). Account 232, in other words, comprises the capitalized cost of connecting telephone equipment on a customer's premises to the local exchange. While appellants agree that some portion of Account 232 should be assigned to the BOCs (see Cal. J.S. 11-13, 15; N.Y. J.S. 5-6), they contend that the "station handling costs" included in this account should instead be assigned to AT&T (Cal. J.S. 11-13; N.Y. J.S. 5-6). California (but not the New York DPS) also contends that "complex intrasystem wiring" should be transferred to AT&T (Cal. J.S. 14-18). Appellants, however, have failed to show that the assignment of the entire Account 232 to the BOCs is inconsistent with the decree.

1. Under FCC accounting procedures, capitalized labor costs associated with the installation and testing of customer premises equipment (CPE), sometimes referred to as "station handling costs," are included as an undifferentiated portion of Account 232. See 47 C.F.R. 31.232. Appellants argue (Cal. J.S. 12; N.Y. J.S. 5) that the plan's assignment of these costs to the BOCs violates the decree's requirement that AT&T retain all "books of account * * * relating to * * * the provision of customer premises equipment to the public" (J.S. App. 174). California also argues (Cal. J.S. 12) that this assignment is inconsistent with the functional separation of assets mandated by the decree because station handling costs relate to CPE, which is an AT&T function under the decree, rather than to the BOCs' exchange functions.

The district court acknowledged (J.S. App. 344) that "a theoretical case could be made" for assignment of station handling costs to AT&T. However, as the court also recognized (*id.* at 344 n.9), the regulatory principles that have governed the recovery of station handling costs have associated them primarily with the growth of the local exchange as a whole rather than

with particular customers. Prior to 1981, it was the Federal Communications Commission's policy to capitalize station handling costs as part of Account 232 and to allow their recovery through rates to all subscribers. The rationale for this regulatory policy was that this method of accounting and recovering the investment in labor costs would make telephone service more affordable and, as a result, increase the value of telephone service for all subscribers by expanding the total subscriber base.[18] When the FCC changed its accounting system to require that station handling costs in the future be expensed rather than capitalized, it provided that embedded investment, which in essence represents a "loan" to all customers to finance the growth of the telephone system, would be recovered over a 10-year period through the rates to those customers.[19] Accordingly, it is consistent with the decree's functional separation provisions and principles to assign accrued station handling costs to the BOCs, which, in accordance with FCC regulatory policy, will be able to continue to recover them from the general body of ratepayers. Since all ratepayers received the benefits associated with the capitalization of these costs, such a result is not, as California contends (Cal. J.S. 13), unfair to "the ratepaying public."

Moreover, as noted by the district court (J.S. App. 344), there is no way to segregate retroactively the time spent connecting CPE from time spent on non-CPE installation work (see AT&T Mot. to Aff. 17). Contrary to California's contention (Cal. J.S. 13), the Department of Justice did not simply accept AT&T's statement on this matter. Rather, the Department investigated in some detail the possibility of segregating

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[18] See *In re AT&T*, 64 F.C.C. 2d 1, 54-55, 354-355 (1977).

[19] *In re Amendment of Part 31, Uniform System of Accounts*, 85 F.C.C. 2d 818, 828-829 (1981).

CPE installation costs and the Department (see U.S. Resp. 91 n.*), as well as the district court (see J.S. App. 344), was persuaded that accurate segregation of these costs is indeed impractical.[20]

The New York DPS's contention (N.Y. J.S. 7) that, by not assigning the accrued station handling costs to AT&T, the plan gives AT&T some unfair advantage in CPE competition also misses the mark. The assignment of station handling costs will not affect AT&T's CPE prices. Those prices will be determined by CPE costs and competitive factors. In a competitive environment, AT&T would not be able to raise CPE prices above CPE costs to recoup past station handling costs (or any other non-CPE cost), since customers would simply buy from AT&T's competitors if it did so. In other words, capitalized past costs are an "asset" to regulated companies only because regulatory policies allow them to be recovered from ratepayers. In a competitive market, these kinds of capitalized installation costs are simply a kind of "bad debt." Thus, if station handling costs were assigned to AT&T, it, unlike the BOCs, could not recover them and likely would have no alternative but to write them off as a loss. Therefore, to assign these costs to AT&T would be inconsistent with established regulatory policy and unfair to AT&T's investors and creditors.[21]

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[20] California contends (Cal. J.S. 13) that "the BOCs in California and New York had already separated all the various elements of Account 232 and that other states would not find it difficult to do the same." The Department concluded, however, that the procedures used in these states could not necessarily be applied in other states and an attempt to segregate Account 232 costs was not, in any event, required by the decree.

[21] Moreover, there is no indication in any statements by the parties or the district court that the assumption of this debt by AT&T was an intended result of the decree, and it would not further competition in any way.

2. Wiring that connects two pieces of customer premises equipment is referred to as "complex intrasystem wiring." It, like station handling costs, is included in asset Account 232. Contrary to California's contentions (Cal. J.S. 14), this wiring is not CPE, nor is it "related to" the provision of CPE within the meaning of the decree. Thus, assignment of this portion of Account 232 to the BOCs also was proper.

California's contention (Cal. J.S. 14) that the decree's definition of CPE "clearly embraces complex inside wiring" is based on a reading of the decree language that fails to take into account the intention of the parties as evidenced by their statements to the district court. The decree defines CPE as "equipment employed on the premises of a person (other than a carrier) to originate, route, or terminate telecommunications" (J.S. App. 177). The government's February 1982 Competitive Impact Statement, filed with the court to explain the meaning and intended effect of the decree, stated (47 Fed. Reg. 7180) that the decree's "structural separation of competitive and noncompetitive markets is consistent with recent regulatory decisions," and specifically cited (*id.* at 7180 n.31) the FCC's *Computer II* decisions, in which the FCC excluded inside wiring (both simple and complex) from the category of CPE.[22]

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[22] See, *e.g.*, *In re Amendment of Section 64.702 of the Commission's Rules & Regulations (Second Computer Inquiry)*, 84 F.C.C. 2d 50, 61 n.10 (1980). Although the FCC currently is considering the deregulation of inside wiring in two proceedings (*Modifications to the Uniform System of Accounts*, 47 Fed. Reg. 44770 (1982); *In re Deregulation of Customer Premises Inside Wiring*, 86 F.C.C. 2d 885 (1981)), it has not classified this wiring as CPE. Moreover, for purposes of construing the decree, subsequent regulatory definitions of CPE are of limited relevance. Rather, the district court properly looked to the FCC's treatment of CPE at the time of the parties' reference to it.

In addition, when the provisions of the plan assigning complex inside wiring to the BOCs were challenged in the district court, the parties emphasized that they intended to follow the FCC's definition of CPE (U.S. Resp. 87; AT&T Resp. 157-158[23]). They added that, in defining CPE to include equipment used to "route" calls, they did not intend to include inside wire (U.S. Resp. 87-88; AT&T Resp. 157-158). Rather, they understood equipment used to "route" telecommunications to refer to equipment that performs a switching function, such as a private branch exchange. Although inside wiring transmits telecommunications, it is not "equipment" and does not "route" calls within the parties' understanding of those terms (U.S. Resp. 88; AT&T Resp. 156-157). The district court, having considered these factors, properly concluded that assignment of inside wiring to the BOCs is consistent with the decree's definition of CPE (J.S. App. 344).

California's argument that, even if inside wiring is not CPE, it should nevertheless be assigned to AT&T because it is "related to" the provision of CPE (Cal. J.S. 14) expands the term "related to" beyond the intent of the parties and ignores the underlying division of assets effected by the decree itself. As the parties explained to the district court (U.S. Resp. 87 n.*; AT&T Resp. 157 n.*), assets "relating to" CPE include separate ancillary assets (*e.g.*, motor vehicles, tools and other work equipment) that are associated with the provision of CPE, but do not include all assets that are "connected to" CPE. Indeed, were California's "connected to" interpretation correct, the wires from customers' premises to the BOCs' central offices also would be "related to" CPE and assigned to AT&T—a

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[23] "AT&T Resp." refers to AT&T Response to Objections to Its Proposed Plan of Reorganization, filed in the district court on March 14, 1983.

result clearly at odds with the provisions and principles of the decree.

Despite California's submission (Cal. J.S. 15), there is no inconsistency between the assignment of complex inside wiring to the BOCs and the fundamental competitive principles underlying the decree.[24] To the contrary, as the district court expressly concluded in rejecting arguments that portions of Account 232 should be assigned to AT&T (J.S. App. 344) (footnote omitted):

> In-place wiring, which is a principal item in Account 232, is as much a "bottle-neck" as are the subscriber access lines. To assign such wiring to AT&T would be to insert AT&T-controlled facilities between the Operating Companies and the subscribers, and such an assignment would thus be entirely inconsistent with the basic purposes of the decree.

Because the assignment of complex inside wiring to the BOCs furthers the decree's competitive objectives, this aspect of the plan was not only approved by the Department of Justice, but was strongly endorsed by the North American Telephone Association, an associa-

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[24] California also argues (Cal. J.S. 15) that it is unfair to local ratepayers to assign inside wiring to the BOCs because "investment in complex intrasystem wiring is now being recovered in part through equipment rates to business customers," who should continue to pay for it "as part of the complex CPE rate" that will be paid to AT&T by users of its CPE. As the government and AT&T explained to the district court, however, it is not clear to what extent the inside wiring investment in Account 232 is currently recovered through rates for embedded CPE; in many jurisdictions the rates for embedded CPE do not recover any portion of the investment in inside wiring or any other component of Account 232 (U.S. Resp. 89-90; AT&T Resp. 162-163). Moreover, after divestiture the BOCs will continue to have available a number of revenue sources for the recovery of these amounts, and there is nothing in the decree that precludes the BOCs from recovering amounts contained in Account 232 in the form of customer-specific wiring charges. *Ibid.*

tion of CPE manufacturers and suppliers that compete with AT&T. Initial Comments of North American Telephone Association at 21-22. The Kansas regulatory commission also specifically supported it (Comments of Kansas Corporation Commission at 2), and only California has challenged it on appeal.

C. The Plan's Allocation of Debt Is Consistent With the Decree

Under the plan, Pacific Telephone's embedded cost of funded debt will be approximately 9.5% (AT&T Mot. to Aff. 21, 24). The next highest embedded cost of funded debt for a BOC is Southwestern Bell's 9.4% (*id.* at 22). The Bell system average embedded cost of funded debt is approximately 8.8% (*id.* at 25 n.23). California claims (Cal. J.S. 18-20) that the plan's allocation of debt to Pacific Telephone violates the decree's requirement that "the quality of the [BOCs'] debt [at the time of divestiture] shall be representative of the average terms and conditions of the consolidated debt held by AT&T, its affiliates and the BOCs at that time" (J.S. App. 184-185).

The next sentence of the decree, however, which California conspicuously fails to mention, expressly provides that "[u]pon application by a party or a BOC, the [district c]ourt may grant an exception to this requirement" (J.S. App. 185). The district court itself required the inclusion of this sentence in the decree (see *id.* at 170-172) to permit non-uniform allocation of embedded debt where "it can be shown that, with respect to a particular Operating Company, its own current debt provides a more equitable basis" (*id.* at 137 n.321). Such a showing was made in the case of Pacific Telephone, and there consequently was no abuse of discretion in the district court's approval of this aspect of the plan.[25]

[25] California claims (Cal. J.S. 20 n.19) that the district court never granted "a formal exception to the decree." If California is suggesting that the court did not grant an exception to the

As the Department and AT&T explained to the district court (U.S. Resp. 117-122; AT&T Resp. 284-299), several factors contribute to Pacific's higher embedded cost of debt. First, the embedded cost of debt for the three high growth "Sun Belt" regional operating companies (Southern-South Central Bell, Southwestern Bell, and Pacific Telephone) is higher than that for BOCs serving other regions. This difference reflects the fact that the BOCs that serve high growth areas have had more frequent and more recent occasion to go to the debt market to meet their service demands. If each of the seven regional companies were required to be divested with the average cost of debt of the Bell System as a whole, the three Sun Belt regions with their higher embedded cost of debt would, in effect, receive a subsidy from the four regional companies that serve more slowly growing areas. Such subsidies, the parties explained (U.S. Resp. 119; AT&T Resp. 278-281), and the court agreed (J.S. App. 222 n. 64), would have been unfair to the lower growth companies and to their subscribers.

Second, Pacific Telephone's embedded cost of debt is higher than the costs of even other high growth BOCs because its financial condition, as measured by its rate of return, stock price, financial ratios, bond ratings,

equal debt quality requirement, its argument lacks merit because the court substantively, if not "formally," granted such an exception. The Department and AT&T both requested that the court grant whatever exceptions to the equal debt quality standard were necessary for approval of the plan (U.S. Resp. 119, 122; AT&T Resp. 298), and the court, which expressly referred to Pacific's unique circumstances (J.S. App. 222 n.64), must be understood to have granted whatever exception to that standard was necessary to support its approval of the debt allocation provisions of the plan. If, on the other hand, California is suggesting that some exception to the *decree* itself is necessary, its argument fails because the decree *does* permit the nonuniform allocation of debt approved by the court.

and the views of analysts and investors, had steadily deteriorated between 1973 and 1980 (see J.S. App. 137 n.320; AT&T Resp. 285-299; AT&T Mot. to Aff. 5 n.3, 23-24). Indeed, the modified consent decree explicitly recognizes Pacific Telephone's unique financial situation, and accordingly provides that Pacific Telephone is to be divested with approximately 50% instead of approximately 45% debt, as in the case of the other BOCs (J.S. App. 184; see J.S. App. 137 & n.320).

Moreover, there is nothing in the modified consent decree or any related proceeding to support California's contention (Cal. J.S. 19) that, because the decree expressly provided Pacific Telephone with a less advantageous debt ratio than the other BOCs, the decree's provision for an exception to the equal debt quality standard could not also be applied to Pacific. On the contrary, as a matter of economics, the decree's debt ratio provision supports application of the equal debt quality exception to Pacific. It is the combination of Pacific's higher debt ratio and its lower bond rating that accounts for the difference between Pacific's embedded debt costs and those of the other Sun Belt companies.[26] In these circumstnaces, a reallocation of embedded debt to give Pacific the systemwide average cost would unfairly impose on other BOC ratepayers or AT&T stockholders costs attributable to factors unique to California. As the district court recognized: "The debt equalization scheme which is proposed by California would inappropriately result in inter-regional subsidies * * *" (J.S. App. 222 n.64).[27]

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[26] In response to objections to this aspect of the plan, AT&T suggested to the district court (AT&T Resp. 285, 297) that the bulk of the difference between Pacific Telephone's embedded cost of debt and the lower debt costs of the other Sun Belt companies is attributable to the downgrading of Pacific's debt between 1973 and 1980 from an "AAA" to an "A−" rating.

[27] Contrary to California's contention (Cal. J.S. 19), there is

Finally, California's argument ignores the fact that, as the district court noted, "neither the decree nor the plan of reorganization adversely affects Pacific's financial condition; if anything, they improved it" (*ibid.*). Indeed, the plan, which was amended in response to the comments of Pacific's management and now has its support, has resulted in significant improvement in Pacific's financial condition. As originally proposed, the plan would have left Pacific with a debt ratio of 50%[28] and an embedded cost of funded debt of 9.7%-9.9% (see AT&T Resp. 295). Under the plan as approved by the district court, however, Pacific is projected to be divested on January 1, 1984, with a 46.5% debt ratio (significantly better than the 50% provided for by the decree) and an embedded cost of funded debt of approximately 9.5% (AT&T Mot. to Aff. 21, 24-25).[29] As a result of the advantages anticipated from the proposed divestiture, Standard & Poor's, on March 28, 1983, raised Pacific's debt rating from A− to A+ (see AT&T Mot. to Aff. 24 n. 22). Thus, as Pacific's management agrees, its financial condition is fully adequate to allow its post-divestiture viability. The district court correctly exercised its discretion in concluding that the embedded debt allocation provisions of the plan are consistent with the provisions and principles of the decree.

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no inconsistency between this allocation and the allocation of contingent antitrust liabilities. As the court noted (J.S. App. 214-215), there were no substantive differences among the BOCs that compelled differential allocation of the contingent antitrust liabilities.

[28] The 50% debt ratio itself represented a reduction from Pacific's 1981 debt ratio of 57%. See AT&T Resp. 267.

[29] See also Amendment to Plan of Reorganization No. 36 (Topic: Long-Term Debt) (April 7, 1983); Second supplemental statement of Donald E. Guinn filed in the district court on April 7, 1983.

CONCLUSION

The Court should accept the appeals and affirm the judgment of the district court.

Respectfully submitted.

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NOVEMBER 1983

Nos. 83-737 and 83-738

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA and THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA,

Appellants,

v.

UNITED STATES OF AMERICA and WESTERN ELECTRIC COMPANY and AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Appellees.

NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE,

Appellant,

v.

UNITED STATES OF AMERICA and WESTERN ELECTRIC COMPANY and AMERICAN TELEPHONE AND TELEGRAPH COMPANY,

Appellees.

On Appeal From The United States District Court For The District Of Columbia

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MOTION TO AFFIRM

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QUESTIONS RESTATED

The Modification of Final Judgment ("MFJ") was entered in this case, by consent of the parties, in August, 1982, and summarily affirmed by this Court under the Antitrust Expediting Act in February, 1983. Under the MFJ, the Bell System is now completing a massive reorganization in which it will divest its local exchange operations on January 1, 1984. These appeals present legal challenges to the parties' plan for implementing this reorganization and to the District Court's holding that this plan is "consistent with [the MFJ's] principles and provisions." The questions presented are:

1. Whether direct Supreme Court review of these appeals is "of general public importance in the administration of justice" within the meaning of the Antitrust Expediting Act?

2. Whether the MFJ, which is to be interpreted as a contract between the parties, see, *e.g.*, *United States* v. *ITT Continental Baking Co.*, 420 U.S. 223, 238 (1975), can be held to have been misinterpreted by the parties who negotiated, drafted, and agreed to it and by the District Judge who entered it?

3. Whether, in any event, the District Court abused its discretion in approving a reorganization plan that achieves the structural reorganization sought by the Justice Department and rests on a careful balancing of the interests of telephone users, competitors in the industry, the Bell System's one million employees, and its three million shareholders?

STATEMENT REQUIRED BY RULE 28.1

Appellee Western Electric Company is a wholly-owned subsidiary of appellee American Telephone and Telegraph Company ("AT&T"). AT&T has no parent company. In addition to its wholly-owned subsidiaries, AT&T has ownership interests in the Southern New England Telephone Company, Cincinnati Bell, Incorporated, and the Cuban American Telephone and Telegraph Company. On January 1, 1984, AT&T will divest seven of its wholly-owned subsidiaries: American Information Technologies Corporation, Bell Atlantic Corporation, BellSouth Corporation, NYNEX Corporation, Pacific Telesis Group, Southwestern Bell Corporation, and U S West, Inc.

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On Appeal From The United States District Court For The District Of Columbia

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MOTION TO AFFIRM

On August 24, 1982, the District Court, with the consent of the parties, entered the Modification of Final Judgment ("MFJ") in this case. This judgment orders a massive structural reorganization of American Telephone and Telegraph Company ("AT&T") and its subsidiaries ("the Bell System"), which is to occur on January 1, 1984. The appeals from the entry of the MFJ were taken directly to this Court under the Antitrust Expediting Act because the District Court found that legal challenges to the reorganization, no matter how insubstantial, created uncertainty which so

imperiled a vital national industry that the earliest possible final disposition of the appeals was a matter of profound "public importance in the administration of justice." 15 U.S.C. § 29(b). This Court ended this potentially crippling "state of limbo" by deciding the appeals during the 1982 term and summarily affirming the District Court. *Maryland* v. *United States*, 103 S. Ct. 1240 (Feb. 28, 1983).

Now, less than two months before the MFJ is to be implemented, two legal challenges to the reorganization have been filed. These are appeals from the District Court's August 5, 1983, order holding that the parties' plan to implement the MFJ is consistent with its provisions and principles. These appeals, too, were certified to this Court under the Antitrust Expediting Act because the Justice Department urged and the District Court found that the public interest requires final disposition of the challenges to the reorganization before January 1, 1984, and that the nation's need for direct Supreme Court review is now, if anything, more compelling than it was nine months ago.

The only way for this Court to put a timely end to the threats to this vital industry is to decide these appeals under the Antitrust Expediting Act before January 1, 1984. But this need not burden this Court or its docket. The fundamental claim of each of the appellants is that the MFJ has been misconstrued both by the parties who negotiated and drafted it and by the District Judge who entered it. Their contentions are frivolous, and the District Court's decision should be summarily affirmed.

STATEMENT OF THE CASE

Throughout this century, the Bell System has provided integrated, end-to-end telephone service. Its wholly-owned Bell Operating Companies ("BOCs") have franchised monopolies that provide local exchange service. The BOCs own and provide simple and complex telephone instruments ("customer premises

equipment" or "CPE") as well as the wires, cables, and other transmission facilities that run through buildings, streets, and alleys and connect this equipment to local switching facilities. These local facilities originate and terminate long distance calls as well as provide for local exchange calling. The BOCs and the Long Lines Department of AT&T also own and operate interexchange facilities that provide intercity telephone service. The Bell System is technologically integrated; it both manufactures telecommunications equipment for its own use through Western Electric Company and conducts basic telecommunications research through Bell Telephone Laboratories.

In the past four decades, the Justice Department has twice filed civil actions under the Sherman Act which sought major structural reorganizations of the Bell System. In 1949, it filed this action. It led to the entry of a Final Judgment in 1956 which imposed a number of limitations on the services that the integrated Bell System may provide.

In 1974, the Justice Department brought its second action, *United States* v. *AT&T*, No. 74-1698 (D.D.C.). By that time, changes in technology and regulatory policy had introduced competition into major new areas of telecommunications: customer premises equipment, intercity telecommunications service, and emerging information services.[1] However, the provision of local transmission and switching functions not only retained natural monopoly characteristics but entrants in the newly created competitive markets required access to these "bottleneck" facilities to compete effectively. The Justice Department alleged that the Bell System had the opportunity and the incentive to misuse

[1]Technological changes had largely eliminated previous distinctions between regulated telecommunications services and unregulated data processing. These changes not only permitted actual and potential competition between telephone companies and data processing vendors, but also gave rise to claims that the 1956 Judgment prohibited the Bell System from using data processing technologies to enhance its services and, therefore, from continuing its long history of innovation. See J.A. 82 n. 198.

its control over these "essential facilities" to restrain competition in related competitive markets. The Department ultimately sought the divestiture and complete separation of the Bell System's local exchange facilities from its intercity, CPE, and manufacturing businesses. Stipulation Package 82, *United States* v. *AT&T*, No. 74-1698 (D.D.C.). Despite AT&T's vigorous contentions that it had not abused its control of its local exchange monopolies and that the public interest would best be served by maintaining the end-to-end integration of the Bell System, it became increasingly apparent during the pendency of the 1974 case that AT&T's ownership of local exchange facilities would be a source of continuing controversy and uncertainty even if it won *United States* v. *AT&T*.[2]

The Modification of Final Judgment. AT&T concluded that the best way to end the continuing antitrust exposure and to obtain freedom from the obsolete constraints of the 1956 Judgment was to agree to the precise structural reorganization that the Justice Department was seeking in the 1974 case. On January 8, 1982, AT&T and the United States stipulated to the entry of a modification of the 1956 Judgment that would require the divestiture of the Bell System's local exchange facilities and vacate the injunctive provisions of the 1956 Judgment. This modification achieved all the Justice Department's antitrust objectives in its four decades of litigation with AT&T.

When the proposed modification was presented to it, the District Court, with the parties' consent, ordered public interest proceedings—which it conducted with great expedition—that went far beyond the requirements of Antitrust Procedures and Penalties Act of 1974, 15 U.S.C. §§16(b)-(h) ("Tunney Act"). These led to an extensive public examination of the pur-

[2]During this period, the FCC and Congress also debated the issues raised by the 1974 case and the 1956 Judgment, and each considered the adoption of onerous regulations, which would apply to AT&T alone, to minimize or eliminate its alleged incentives and ability to suppress competition through control over local monopolies.

pose, meaning, and effect of each of the proposed modification's provisions.

On August 11, 1982, the District Court held that this proposed reorganization of the Bell System was an entirely appropriate antitrust remedy and manifestly in the public interest, provided several changes were made. See J.A. 1-172. Only two are relevant here. First, the court required the addition of a Section VIII(H) to codify the parties' representations as to the divested companies' capital structures. J.A. 171-72. It provides that the divested BOCs may have debt ratios of no greater than approximately 45 percent, except that in the case of Pacific Telephone and Telegraph Company ("Pacific" or "Pacific Telephone") the debt ratio could be as high as approximately 50 percent.[3] Section VIII(H) further prescribes that the "quality of the debt" of the divested BOCs shall be "representative of the average terms and conditions of the consolidated Bell System debt," but permits exceptions for companies whose current debt "provides a more equitable basis." J.A. 137 n. 321. Second, the District Court required that AT&T's plan for implementing the reorganization be submitted and approved by it, J.A. 172, as well as by the Justice Department. See MFJ, §I(A); J.A. 174.

On August 24, 1982, the District Court, with the parties' consent, entered the MFJ, which contained all the District Court's proposed revisions. On August 26, 1982, the District Court authorized approximately 110 public and private entities and organizations to intervene in this case to appeal the entry of the MFJ, to participate in future District Court proceedings relating to AT&T's plan for implementation of the reorganization, or

[3]During the public interest proceedings, AT&T had shown that Pacific then had a 57% debt ratio because of its adverse local regulatory treatment and financial history and that fairness to AT&T and the other BOCs required that Pacific be divested with a debt ratio of up to approximately 50 percent debt. See, *e.g.*, AT&T Reply Brief, p. 95 n.** (June 24, 1982); see also AT&T Response To Public Comments, pp. 76-77 (May 21, 1982); pp. 23-24, *infra*.

to appeal an order approving that plan. J.A. 191-94. Seventeen intervenors appealed from the entry of the MFJ. On November 10, 1982, the District Court certified these appeals directly to this Court under the Expediting Act, 15 U.S.C. §29(b). This Court summarily affirmed the MFJ on February 28, 1983. *Maryland* v. *United States,* 103 S.Ct. 1240.

Plan of Reorganization. On December 16, 1982, AT&T submitted the 471-page Plan of Reorganization ("Plan") that specified the detailed principles and procedures that will govern the division of the Bell System's resources and the implementation of the divestiture under Section I(A) of the MFJ. See J.A. 174-75.[4]

Two provisions of the Plan are directly pertinent to these appeals. First, because the MFJ splits the telephone network at the interexchange switches, MFJ, §I(A)(2), (4), J.A. 174-75, the Plan assigns the BOCs all the investment in telephone plant located on the exchange side of those switches, including all wires, cables, and transmission facilities and excluding only customer premises equipment. Plan, 6-142. Second, the Plan provides that no BOC will be assigned more debt than the MFJ-prescribed debt ratios would allow and that, when necessary to assure compliance with Section VIII(H), AT&T will assume BOC debt. Plan, 191-97. The Plan also then prescribed that each of the companies would be divested with their existing embedded costs of debt. It explained that any attempts to equalize the costs among companies would introduce improper subsidies among regions, "such as low growth areas subsidizing faster growing areas." Plan, 195. At

[4]On October 4, 1982, AT&T and the BOCs had filed the BOCs' proposals for the division of the country into the exchange areas ("LATAs") and associated independent telephone company territories (see MFJ, §IV(G); J.A. 178-79) that will determine which network facilities are exchange facilities to be divested and which are interexchange facilities to be retained by AT&T. After extensive proceedings, these LATAs were, with minor modifications, tentatively approved in an April 20, 1983, Opinion and finally approved in a decision issued on July 8, 1983. J.A. 284-308.

that time, the regional companies had embedded costs of debt of between 8.5% and 9.1%, with the exception of Pacific Telephone which, due to its adverse financial history (see p. 5 n. 3, *supra*), was then at 9.9%. Plan, 194-95. However, more recent data set forth in the Prospectus that the Bell Companies filed with the SEC on November 16, 1983, indicates that, with the exception of Pacific, the debt ratios of the to-be-divested companies will range from 8.79% (Bell Atlantic Corporation) to 9.4% (Southwestern Bell Corporation). See AT&T Information Statement and Prospectus, pp. 63, 83, 105, 127, 151, 174, 195.

The District Court's Proceedings on AT&T's Plan. The District Court ordered each of the designated Chief Executive Officers of the seven to-be-divested regional companies ("regional CEOs") to submit sworn statements that addressed whether AT&T's Plan of Reorganization will leave them as financially viable companies with the resources necessary "to perform the functions described in the decree" and whether any provision of the Plan was interposed over their objections. See J.A. 164-65. The seven regional CEOs thus each filed affidavits on December 16, 1983. Only one designated CEO directly questioned the financial viability of his region: Donald E. Guinn of Pacific Telephone who raised objections to the treatment of Pacific Telephone's debt.

In response to Mr. Guinn's objections, AT&T, on April 7, 1983, amended the Plan to provide that Pacific would be divested in a more favorable financial position than is required by the MFJ: an expected debt ratio of less than 47%, not the 50% that the MFJ permits, and an average embedded cost of debt expected to be 9.5%. Mr. Guinn thereupon filed a supplemental sworn statement that withdrew his previous objections. See Second Supplemental Statement of Donald E. Guinn (April 7, 1983). This ended the controversy with Pacific.

Under the procedures that the District Court established, some 50 intervenors and *amici curiae* filed comments and objections to the Plan with the Justice Department and with the District Court.

These pleadings raised literally hundreds of issues and addressed virtually every provision of the Plan.

Section I(A)(1) of the MFJ required the Justice Department to conduct an independent examination of the Plan and to approve or to disapprove it. J.A. 174. Thus, after its initial review of the comments, the Department advised AT&T that over 20 amendments had to be made before it could approve the Plan. AT&T formally made 23 separate amendments to the Plan on March 14, 1983, when it filed its Response to Objections to its Proposed Plan of Reorganization ("AT&T's Response"). After reviewing AT&T's Response, the Department on March 24, 1983, submitted the Response of the United States to Public Comments and Action on AT&T's Proposed Plan of Reorganization ("Response of the United States"). It stated that the Department would not formally approve the Plan unless an additional twelve amendments were made. AT&T agreed to each of these amendments.

Notwithstanding the Department's approval of the Plan, as amended, the District Court called for the submission of additional memoranda from the parties, the seven to-be-divested regional companies, and the intervenors on six separate issues. It conducted a hearing on June 2, 1983, in which it heard live testimony from three of the designated regional CEOs. On July 8, 1983, the court issued a 159-page opinion (J.A. 195-330) which concluded that the amended Plan would not be approved unless it were further modified in six major respects—none of which is relevant to these appeals. J.A. 328-330. California thereafter asked the District Court to reconsider its ruling that complex inside wiring was properly assigned to the BOCs. Contrary to California's misstatement (J.S.7), the District Court explicitly addressed and rejected California's complex inside wiring claim, see J.A. 339 n. 18, 343-44, as well as the two other claims raised in these appeals. See J.A. 344 ("station handling"); J.A. 221-22 n. 64 (Pacific debt).

AT&T amended the Plan to adopt the District Court modifications, and the court entered an order approving the amended Plan

on August 5, 1983. J.A. 349-50. The State of California and the California Public Utilities Commission ("California") filed a notice of appeal from this decision on August 10, 1983. The New York State Department of Public Services ("New York") filed a notice of appeal on September 13, 1983.

On August 25, 1983, the Justice Department filed a motion urging the District Court to certify California's appeals and any subsequent appeal from the approval of the Plan directly to this Court under the Antitrust Expediting Act, 15 U.S.C. §29(b). AT&T supported this motion. Neither California, New York, nor any other intervenor opposed it. On September 7, 1983, the District Court issued the certificate, finding that the same basic considerations that dictated direct Supreme Court review of the entry of the MFJ are "equally applicable" here. J.A. 351-54.

REASONS FOR SUMMARY AFFIRMANCE

By directly reviewing the entry of the MFJ last February, this Court recognized that this case has such profound importance for the national economy that it epitomizes the government antitrust actions in which Congress intended direct Supreme Court review of a District Court's final decision. Because a failure to resolve the legal challenges to this reorganization before it occurs on January 1, 1984, would threaten the very success of this massive effort, the considerations that led the Court to review the entry of the MFJ have even greater force now, only weeks before divestiture. These appeals, moreover, present claims that are far less substantial than those as to which the Court affirmed summarily last February. The decision below should be summarily affirmed.

I. EXPEDITION OF THESE APPEALS UNDER THE EXPEDITING ACT IS A MATTER OF PARAMOUNT PUBLIC IMPORTANCE.

In the Antitrust Expediting Act, 32 Stat. 823, *as amended*, 15 U.S.C. §29(b), Congress found that public antitrust cases can have an enormous "impact on the economic welfare of this nation," that they "are unlike other federal cases," and that it is often

necessary and appropriate to expedite the final decision in such cases by making final judgments directly appealable to this Court. H.R. Rep. No. 93-1463, 93d Cong., 2d Sess. 14 (1974); see S. Rep. No. 93-298, 93d Cong., 1st Sess. 3-4 (1973). Although Congress has eliminated the previous requirement that there be direct Supreme Court review in all Government antitrust cases, see 15 U.S.C. §29(a),[5] it retained direct appeals for those Government antitrust cases in which "the district judge who adjudicated the case enters an order stating that immediate consideration of the appeal by the Supreme Court is of general public importance in the administration of justice." 15 U.S.C. §29(b). In such cases, the Act provides that this Court may then either "dispose of the appeal . . . in the same manner as any other direct appeal" or remand it to the appropriate court of appeals, where it will be subject to the ordinary appellate procedures. *Id.*[6]

These appeals present precisely the kind of cases that Congress intended to preserve for direct Supreme Court review. By summarily affirming the entry of the MFJ, this Court recognized that any significant delays in the final resolution of the legal challenges

[5]Congress wished to relieve the Court of the burden of reviewing voluminous records. See S. Rep. No. 93-298, *supra*, p. 8. That is not a consideration here because the question presented is the purely legal question of whether the parties who drafted the MFJ and the District Judge who entered it have misinterpreted it and, even if they have, whether the order approving the Plan represents an abuse of the District Court's discretion.

[6]The Expediting Act, however, was not intended to "bestow on the Supreme Court an unqualified discretion to hear or not hear a case." H.R. Rep. No. 93-1463, *supra*, pp. 13-14 (1974). On the contrary, Congress "intended that the Supreme Court hear cases that are of general public importance in the administration of the antitrust laws." *Id.* The standard for direct appeals is *not* that the case raises novel or unsettled legal issues or is otherwise immediately review-worthy under 28 U.S.C. §1254(1) (Supreme Court review prior to judgment in the Court of Appeals). *Id.* As the District Court stated in its opinion certifying these appeals directly to this Court: "Even though it is not likely that the appeals will present questions of legal significance, they are clearly of general public importance." J.A. 352 (footnote omitted).

to the reorganization of the Bell System create uncertainty that threatens the interests of the Nation. See J.A. 148-49. As the District Court found, the uncertainty that the instant appeals create threatens the same serious adverse consequences; if anything, expedition is even more necessary now because the "January 1 deadline" is only six weeks away and the adverse consequences of continued uncertainty "would be multiplied if the divestiture proceeded on January 1, 1984, while the plan of reorganization was still under challenge in the courts." J.A. 353.

California (J.S. 8-9) and New York (J.S. 8) argue that their appeals raise issues that are discrete and unrelated to other aspects of the reorganization and that delay in the final resolution of their appeals for months or even years after divestiture will have no adverse consequences. As is more fully explained in AT&T's Motion For Expedition Of These Appeals, this is simply incorrect. These challenges implicate the heart of the reorganization. If a decision were issued after divestiture that required a reassignment of complex inside wire, for example, it would disrupt operations, business planning, customer relationships and regulatory decisionmaking and would require post-divestiture reassignments of employees and possible reallocation of BOC debt. Similarly, if California were to prevail on its claim that Pacific's average cost of debt is too high, the embedded debt of the BOCs would have to be pooled and reallocated among the BOCs. Finally, a reversal on any of the grounds raised could also lead the parties to reconsider these and other provisions of the MFJ and Plan, because any significant change in the Plan could destroy the careful balance the MFJ was intended to achieve. The pendency of the appeals, accordingly, creates uncertainty that precludes reliable valuation of any of the to-be-separated companies, impairs access to capital markets, impedes operational decisions, threatens massive post-divestiture disruptions, and prolongs the very interrelationship among Bell System companies that entry and affirmance of the MFJ were supposed to end.

II. THE APPEALS HAVE NO SUBSTANCE AND SHOULD BE SUMMARILY AFFIRMED.

California's and New York's appeals are each frivolous, and the District Court's order approving the Plan of Reorganization should therefore be summarily affirmed. Appellants contend that the three provisions of the Plan—relating to "complex" inside wiring, accounting entries for "station handling", and the average cost of Pacific Telephone's long term debt—violate the MFJ. These contentions are insubstantial on their face. As an antitrust consent decree, the MFJ "is to be construed for enforcement purposes basically as a contract" between the parties to the case, *United States* v. *ITT Continental Baking Co.* 420 U.S. 223, 238 (1975); see *United States* v. *Armour & Co.*, 402 U.S. 673 (1970).

The decisive consideration here is that the challenged provisions of the Plan were drafted to implement the MFJ by one party to the case (AT&T), reviewed and agreed to by the other party (the United States), and were approved as consistent with the MFJ by the District Court following extensive public proceedings. Appellants' contentions thus reduce the untenable claim that an antitrust consent decree can be misinterpreted both by the parties who negotiated it and agreed to it and by the District Judge who entered it after conducting proceedings going beyond those prescribed by the Tunney Act.[7]

Moreover, even if there were a basis for appellants' claim that MFJ has somehow been modified, *sub silentio*, the District Court's decision is reviewable, *at most*,[8] for abuse of discretion.

[7]Because a principal purpose of that Act is to eliminate subsequent disputes over the meaning of antitrust consent decrees, see H.R.Rep. No. 93-1463, 93d Cong. 2d Sess. 8 (1973), the fact that the District Court upheld the interpretations of the parties who drafted and negotiated the MFJ should be conclusive.

[8]This Court has held that where, as here, there is no claim of fraud, lack of jurisdiction, or mistake, a judicial order "rendered by consent [of the parties] is always affirmed without considering the merits of the case." *Swift & Co.* v. *United States*, 276 U.S. 311, 323-24 (1928) (Sherman Act); *accord*, *NLRB* v. *Ochoa Fertilizer Corp.*, 368 U.S. 318, 323 (1961).

See, *e.g.*, *Patterson* v. *Newspaper & Mail Deliverers Union*, 514 F.2d 767, 771-72 (2d Cir. 1975) *cert. denied*, 427 U.S. 911 (1976); *Metropolitan Housing Development Corp.* v. *Village of Arlington Heights*, 616 F.2d 1006, 1015 (7th Cir. 1980). Because the challenged provisions of the Plan promote the Justice Department's antitrust objectives and are manifestly reasonable, neither appellant even claims, much less establishes, that the District Court's discretion was abused.

Appellants' claims, accordingly, can be rejected without even considering the merits of their arguments. However, a detailed examination of their contentions even more vividly demonstrates that there is no basis whatever for holding that the District Court's approval of the Plan was improper.

A. The Plan Properly Assigned The Investment In "Complex" Inside Wiring And "Station Handling" To The BOCs.

California and New York challenge the Plan's assignment to the BOCs of investment in portions of one of the BOCs' accounts, Account 232—Station Connections. California challenges the assignment of "complex" inside wiring and—contrary to its position in the District Court—of all "station handling" costs. In contrast, New York confines its challenge to the treatment of "station handling." Neither claim has any merit.

All of the investment in Account 232 has been incurred for only one purpose: to extend local transmission facilities and connect them to newly installed telephone handsets located on customers' premises. The investment in Account 232 includes the wire that runs from outside the customer's premises through his walls to the standard telephone jack ("simple inside wire"), the wire that runs through walls and floors of skyscrapers and other buildings to connect private switchboards with jacks for the individual telephone handsets ("complex inside wire"), the jacks themselves, and other physical assets. Account 232 "investment" also includes the accounting entries that have been made when tele-

phone company service personnel visit customers' premises to install this wiring, test it, and connect it to handsets or private switchboards. These are "capitalized" labor costs.

The assignment of the entire Account 232 investment to the BOCs follows from the terms and purpose of the MFJ. By its terms, the MFJ splits the telephone network at the point of interexchange switching and provides that all investment on the exchange side of those switches be assigned to the BOCs, with the sole exception of customer premises equipment. MFJ, §§I(A)(2), (4); J.A. 174-75. This is because one of the basic purposes of the MFJ is to separate ownership of the Bell System's interexchange facilities and CPE from its local transmission and switching facilities and thereby to assure that AT&T does not control both an embedded CPE business and "bottleneck" facilities to which all CPE vendors must have access.

Accordingly, in the District Court, both the Justice Department and the trade association of customer premises equipment competitors of AT&T vigorously argued that the facilities in Account 232 must be assigned to the BOCs. Specifically, each argued that the assignment of either "complex" or "simple" inside wire to AT&T would give it control over a facility essential to the CPE business and give it the very opportunity to deny access to CPE competitors that the MFJ was intended to end. See Response of United States, pp. 87-90; Comments of North American Telephone Association, pp. 21-22; *accord*, Kansas Public Service Commission Comments, p. 2.[9] The District Court agreed. It found that both simple and complex inside wire is part of the local

[9]The Department's and the CPE vendors' position flatly refutes California's argument (J.S. 15) that the assignment of inside wire to the BOCs will permit AT&T to "reap excessive profits" or "undercut its competitors" in the CPE market. Whether or not AT&T has a sunk investment for complex inside wiring on its books is irrelevant to its competitive posture. The price AT&T can charge for CPE is dictated by competition. If AT&T tried to charge more than a competitive price for its CPE, customers would turn to other vendors.

exchange "bottleneck" and that assignment of it to AT&T would "insert AT&T-controlled facilities between the Operating Companies and the subscribers, and . . . thus be entirely inconsistent with the basic purposes of the decree." J.A.344. Even if the terms of the MFJ were not so clear, these findings preclude any claim that the District Court abused its discretion in approving this provision of the Plan.

Complex Inside Wire. California acknowledges that the Plan properly assigned "simple" inside wiring to the BOCs. However, of the 110 intervenors in this case, California alone now contends that "complex" inside wiring is somehow different and should have been assigned to AT&T, not the BOCs. It accuses the District Court of having "failed to address" California's contention. (J.S. 7) This is false. The court explicitly held, in ruling on California's own request for reconsideration, that complex inside wiring is part of the "local exchange bottleneck" and that California's position is therefore "entirely inconsistent with the basic purpose of the Decree." J.A.344.

California's arguments boil down to an attempt to rewrite the MFJ. California recognizes that the parties unequivocally intended to assign all inside wiring to the BOCs and that inside wiring was therefore excluded from the MFJ's definition of CPE.[10] Nonetheless, California now makes (J.S. 14-15) two arguments under which complex inside wiring would become CPE. First, California argues that complex inside wire is "equipment employed . . . to route telephone calls" and thus satisfies the MFJ's definition of CPE. MFJ, §IV(E); J.A. 177. But wire transmits

[10]California acknowledges that the parties implemented their intention by incorporating the definition of CPE from the FCC's decision in the *Second Computer Inquiry*, 84 F.C.C.2d 50, 61 n. 10 (1980)—a definition that expressly excludes inside wiring. This definition fixes the meaning of MFJ. The fact that the FCC may hereafter change its definition of CPE, under the different standard of the Communications Act of 1934 (see California J.S. 17 n. 18), is irrelevant to the meaning of the MFJ.

calls; it does not "route" them. This part of the definition of CPE refers only to switching equipment, not to wire. See, *e.g.*, Response of United States, p. 88.

California also argues that complex inside wire should be assigned to AT&T on the theory that it "relates to" CPE within the meaning of Section I(A)(2) of the MFJ. J.A. 174. But, again, the parties have made it explicit that assets "relating to" CPE are confined to those necessary for its installation, sale, or delivery, such as trucks or phone stores. See, *e.g.*, Response of the United States, p. 87, n.*; AT&T's Response, p. 157 n.*. More fundamentally, California's two textual arguments are flatly inconsistent with its proposed distinction between "complex" and "simple" inside wiring and would vitiate the whole MFJ. If complex inside wiring "routes" calls or "relates" to CPE, then so do simple inside wiring, telephone jacks, and even the wire that runs from outside customers' premises through streets and alleys to the BOCs' central offices—all of which epitomize the "bottleneck" facilities that are to be divested and structurally separated from AT&T's CPE business.

Station Handling. In contrast to California, New York acknowledges that the BOCs were properly assigned both the complex and simple inside wiring. However, New York objects to the treatment of a different aspect of Account 232: a portion of the accounting entries that reflect telephone servicemen's "capitalized labor." New York concedes that the major portion of this capitalized labor "investment" represents the servicemen's installation and testing of inside wiring and was properly assigned to the BOCs. However, New York notes that servicemen also perform the function of connecting the inside wire to telephone handsets—known as "station handling"—and New York insists that some portion of the capitalized labor in Account 232 should now be allocated to station handling and assigned to AT&T. Ironically, although California now makes the same argument, it express-

ly disclaimed New York's position in the District Court because of the severe adverse effect it would have on the economic balance that the MFJ was designed to preserve. See also J.A. 339 n. 18.[11]

There is no merit to New York's and California's current claim. Station handling represents the capitalization of labor costs incurred in connecting local transmission facilities to telephone desksets. There is no principled basis for distinguishing this function from any other function whose cost is recorded in Account 232. Station handling is simply the last act in establishing a working station connection.

Furthermore, there is no way to determine what portion of the "capitalized labor" in Account 232 represents time spent in connecting a customer's telephone instrument to local transmission facilities and what portion the time spent testing and installing inside wire or telephone jacks. Telephone company service personnel simply have had no reason or occasion to make an artificial distinction between these interrelated functions and have made no record of the time spent on the respective tasks because the FCC's accounting rules have never made any such distinction. See 47 C.F.R. §31.232. Contrary to appellants' arguments, there is no way to segregate station handling costs from all other costs in Account 232—other than sheer guesswork. The appellants' own arguments vividly demonstrate that any attempt by the District Court to make such "estimates" would introduce into the asset assignment process precisely the valuation proceedings and

[11]In the District Court, California urged only that there be a distinction between complex and simple inside wiring. Because California recognized that the assignment of simple inside wiring and associated station handling "investment" to AT&T would present "special cost recovery problems" for the Bell System's three million shareholders, see California's Further Comments On The Plan Of Reorganization, pp. 20-21 (February 11, 1983), California confined its claim to complex inside wiring. See also California's Reply Comments on the Plan of Reorganization, pp. 25-26 (April 12, 1983) (complex inside wiring "is distinguishable from other elements of Account 232, and so should be transferred to AT&T").

unauditable uncertainty that the MFJ was carefully drafted to avoid.[12] See J.A. 124-33. For these reasons, the District Court found that "there is no practical way to separate out" this part of the capitalized labor entries. This holding implemented the terms and purposes of the MFJ and, in any event, was a sound exercise of discretion.

The appellants' further arguments are meritless. First, New York's argument (J.S.7) that a failure to assign station handling investment to AT&T is anticompetitive rests on a misunderstanding of these accounting entries.

Station handling "investment" is not a physical asset. It is an accounting entry to reflect the fact that, prior to 1981, all the labor costs imputed to the installation of wiring and telephone instruments were not recovered at the time of their installation, but instead were capitalized and recovered through depreciation charges over many years. This occurred pursuant to regulatory policies designed to keep the price of establishing new telephone service artificially low. Beginning on January 1, 1981, the FCC ordered companies to begin recovering all such costs at the time each installation is made, which, under accounting principles, means that the labor costs are "expensed."[13] Because the FCC has ordered that the investment in Account 232 on January 1, 1981, be amortized over 10 years, the Bell System's shareholders' recovery of this pre-1981 investment is nearly 30% complete; the

[12]New York's estimates of the BOCs' station handling "investment" in New York alone vary by a factor of six—from $106 million to $600 million. J.A. 7. New York's suggestion (J.S. 6) that this extraordinary margin of guesswork is typical of the uncertainty in dividing other assets pursuant to the MFJ is wrong. In every other provision of the Plan, whole accounts or subaccounts are assigned, or accounts (*e.g.*, for land and buildings) are divided because records exist that permit the assets to be accurately separated and assigned.

[13]*Amendment of Part 31 (Uniform System of Accounts)*, 85 F.C.C. 2d 818, 819, 823-29 (1981). The FCC gave state regulatory commissions the option of requiring the expensing of all these costs after January 1, 1981, or of phasing in expensing over a four year period.

issue here pertains only to the amounts now in Account 232: *i.e.*, approximately 70% of the capitalized labor costs incurred before 1981.

These accounting entries and regulatory recovery principles are simply irrelevant to post-divestiture competition.[14] For example, there are instances in which two telephones were manufactured in 1980 and are identical in all respects, except one was installed by a BOC in 1980 (with capitalized labor of $60 recorded in Account 232) and the other was installed by a BOC in 1981 (and no entry made in Account 232). Both telephones will be assigned to AT&T on January 1, 1984. Because the two telephones are identical, they will be offered at the same price, and the price that AT&T will be able to charge cannot exceed competitors' prices in the intensely competitive CPE market. It is absolutely irrelevant to AT&T's price—as well as to prices of AT&T's competitors—whether AT&T is also assigned the entire sunk "investment" in Account 232 for the telephone installed in 1980. It is equally irrelevant to post-divestiture competition whether AT&T is assigned that portion of the total "capitalized labor" in Account 232 that may be estimated to represent "station handling."[15]

Second, appellants argue that assigning the disputed parts of Account 232 to the BOCs will unfairly burden regulated rate-

[14]California's related argument that the Plan's assignment of station handling to the BOCs permits AT&T to obtain CPE at less than its full cost is even more fundamentally erroneous. First, it ignores that the reorganization of the Bell System is not a sale of assets, but a split of a single enterprise's assets in which purchase and sale concepts have no place—as the District Court explicitly found when it rejected one of California's earlier claims. J.A. 125-30. Second, the assets will be transferred onto AT&T's books of account at their historical "book" value, which the District Court found to be the correct valuation and cost standard for the transfers. J.A. 130-33.

[15]California's own regulatory practice confirms the irrelevance of sunk station handling costs to competitive CPE pricing. As California acknowledges (J.S. 12 n. 13), no portion of the station handling costs recorded in Account 232 is included in the prices at which it has authorized Pacific to sell CPE to telephone subscribers.

payers. This argument not only rests on a misunderstanding of these accounting entries, but also demonstrates why the District Court held that an assignment of all of Account 232 to AT&T would destroy the careful economic balance that the MFJ sought to preserve and needlessly destroy the investments made by the Bell System's three million shareholders. J.A. 339 n.18; see also *id.* at 323-28.

The reason that there are entries in Account 232 today is that regulatory commissions did not permit labor and other costs to be expensed and recovered at the time telephone installations were made—as they would have been in an unregulated business—until January 1, 1981. Although the Bell System's shareholders have recovered their costs for installations made after January 1, 1981, they have had a severe cost-recovery problem relating to the Account 232 investment that is on the BOCs' books and that pertains to the period before January 1, 1981. The FCC has adopted an equitable solution. It requires local exchange carriers, like the BOCs, to recover the Account 232 investment over a ten year period. The BOCs have been permitted to make this recovery, in large measure, from local ratepayers.[16] This reflects two facts. First, this sunk investment cannot be recovered by inflating CPE prices because of the intensely competitive markets for CPE that the FCC has created.[17] Second, it is the fairest mode of recovery because general ratepayers, as a class, benefitted from the expansion of telephone service that the previous artificially low installation charges made possible.

The effect of California's and New York's proposal would be to interrupt the process of cost recovery (now 30 percent completed)

[16]The BOCs are also free to recover these sunk investments from current users of inside wire. Under the Plan, this source of revenues will continue to be available to the BOCs.

[17]For example, AT&T could not recover the entire investment from the current users of inside wire or CPE customers because the total investment built up over years far exceeds the costs associated with current customers' use.

in midstream and renege on the regulatory obligation to permit the Bell System's three million shareholders to recover their capital. For these reasons, the assignment of the disputed portions of Account 232 to AT&T would upset the careful economic balance that the MFJ was designed to preserve, J.A. 339 n. 18—as well as violate its explicit terms and competitive objectives.

B. The Plan Provides For The Divestiture Of Pacific Telephone In A More Favorable Financial Condition Than The MFJ Requires.

California also objects to the Plan's provision that Pacific Telephone will be divested with a higher average cost of debt than the other BOCs. This claim is not only contrary to the plain terms and purposes of the MFJ, but ignores the reality that the amended Plan will leave Pacific in a far more favorable financial position than is required by even California's own construction of the MFJ.

Under the amended Plan, Pacific will be divested with a debt ratio of approximately 46.5%, which is substantially less than the approximately 50% debt ratio that Section VIII(H) of the MFJ permits, and an average cost of funded debt of approximately 9.5%. California's position is that the average cost of Pacific's debt must be reduced to 9.2% (J.S. 20 n.20). California reasons that this further reduction must occur before Pacific's debt will be of a "quality . . . representative of the average terms and conditions" of the Bell System's debt. See MFJ, §VIII(H), J.A. 184-85.

California's claims are meritless. Section VIII(H) does not require equalization of debt costs between Pacific and the other BOCs. In prescribing a higher debt ratio for Pacific than for the other BOCs, Section VIII(H) expressly recognizes that Pacific cannot be placed on an equal footing with the other companies. Pacific's average cost of debt is higher than the other BOCs for the same reason that the MFJ permits it to be divested with more debt: its adverse financial history and regulatory treatment by California (see p. 5 n. 3, *supra*; pp. 23-24, *infra*). The District

Court could not have authorized disparate treatment of Pacific in one clause of Section VIII(H) and then required complete equality in a second. See AT&T Response, 277-278.

But even if the first sentence of Section VIII(H) required the equalization of debt costs, the second sentence of the section —which California ignores—provides that "the Court may grant an exception to this requirement." J.A. 185. An exception is appropriate if it "can be shown that, with respect to a particular Operating Company, its own current debt provides a more equitable basis." J.A. 137 n. 321. Before the District Court, both AT&T and the United States took the position that if an exception was required to permit Pacific to be divested with its own cost of debt, the District Court should grant that exception in view of Pacific's unique financial and regulatory history.[18] In approving the Plan, the District Court unequivocally rejected California's claim that the MFJ requires a further reduction in Pacific's average cost of debt. J.A. 221-22 n. 64.

The District Court gave four separate reasons for rejecting California's position. Each is unassailable. First, the District Court found that any attempt to equalize Pacific's and the other BOCs' debt costs would require ratepayers in regions of the country that have experienced slow growth to subsidize telephone service for ratepayers in regions that have experienced high growth and in which the local telephone companies have had to borrow more often and more recently.[19] J.A. 221-22 n. 64. The subsidy California seeks would give Pacific lower debt costs than Southwestern Bell (9.4%), as to whose debt there is no dispute, and thus—perversely—would treat Pacific more favorably than

[18]See AT&T's Response, p. 298; Response Of United States, pp. 119, 122.

[19]California is in error when it asserts (J.S. 19) that equalizing the BOCs' cost of debt would not affect the other BOCs' finances or require substantial transfers among companies. Illinois Bell and Northwestern Bell, for example, would have their annual debt costs increased by approximately $10 million and $13 million in the first year alone; and overall, four of the seven regional companies would be net payers to the other three regions. See AT&T's Response, p. 279. The Staff of the Federal

another "Sun-belt" company that was not afflicted with the same history of unreasonable regulation and financial difficulty. Indeed, contrary to California's position, Pacific's chairman agreed to the divestiture of his company with a debt cost of 9.5% precisely because such costs were "in line with the other high growth 'Sun-belt' Bell Operating Companies." Second Supplemental Statement of Donald E. Guinn, p. 1 (April 7, 1983). As the District Court held, to further subsidize Pacific's debt costs in these circumstances would be manifestly unfair.

Second, the District Court found that such subsidies would lead to "new and continuing AT&T entanglements with the Operating Companies." J.A. 221-22 n. 64. The District Court correctly held that this would preserve the very financial integration of the Bell System that the MFJ was intended to end. *Id.*

Third, the District Court found that Pacific's adverse financial condition before divestiture was "due in large part to the action of California's regulators" (J.A. 137) and that "Pacific will be divested in as financially sound a condition as its prior history permits." J.A. 221-22 n. 64.[20] Contrary to California's arguments, the record demonstrates that, for more than a decade, the California commission steadily depressed Pacific's earning to levels that did not attract needed equity capital and that Pacific, consequently, was forced to rely increasingly on debt financing, which raised its cost of debt and raised its debt ratio from 48.6% in 1973 to 59.1% in 1980. This led to steady deterioration of

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Communications Commission agrees. It found that to divest Pacific Telephone with the Bell System's average cost of debt "would amount to a subsidy to [Pacific] and California consumers directly by other segments of the Bell System and indirectly by other Bell System customers." FCC Staff Analysis of AT&T Reorganization Plan, pp. 27-28 (February 11, 1983).

[20] *Accord*, FCC Staff Analysis of AT&T Reorganization Plan, pp. 27-28 (February 11, 1983) ("[Pacific's] debt ratio and cost of debt may be considered indicative of the condition of utilities in California . . . [Pacific's] financial difficulties, then, may simply reflect the risks a utility faces in California.").

Pacific's debt rating (from AAA in 1973 to A– in 1980).[21] See Sworn Statement of Donald E. Guinn, p. 9 (filed December 16, 1982). The MFJ manifestly was not intended to restore Pacific to the same balance sheet condition as those BOCs who have been subjected to less onerous regulatory treatment. To the contrary, Section VIII(H) recognizes that Pacific's debt situation differs from that of the other BOCs.

Finally, the District Court found that the Plan would, if anything, produce an impressive improvement in Pacific's financial condition, far in excess of that enjoyed by any other BOC. J.A. 221-22 n. 64.[22] Indeed, Pacific will be divested in a better financial position than is required by any interpretation of the MFJ, including California's. The following table, setting forth Pacific's total annual debt expense under four assumptions, illustrates this point.

Pacific Telephone's Debt Expense

Assumption	Debt Ratio	Total Debt (billions)	Cost of Debt	Annual Debt Expense (millions)
1. MFJ As Construed By Parties	50.0%	$6.104	9.7%	$592
2. MFJ As Construed by California	50.0%	$6.104	9.2%	$562
3. Plan of Reorganization	46.5%	$5.676	9.5%	$540
4. California Proposal in this Court	46.5%	$5.676	9.2%	$522

[21]During those years, the securities rating firms were unanimous in their view that the principal cause of Pacific's decline was unreasonable state regulation. See Duff & Phelps, Inc., "Review of Pacific Telephone," p. 1 (November 29, 1980) ("We would rank the California regulatory climate as about the worst among any that regulate the Bell System."); Standard & Poor's, *Fixed Income Investor*, p. 171 (October 22, 1977) ("regulatory treatment in California has been consistently below average for Pacific Telephone"). See also Moody's, *Bond Survey*, p. 524 (November 12, 1979).

[22]On March 28, 1983, Standard & Poor's, a securities rating firm, raised Pacific's debt rating from A– to A+, citing "the singular advantages that the company is expected to realize from divestiture." Standard & Poor's, *Credit Week*, p. 1942. Pacific was the only Bell System company to have its debt rating raised. *Id.*

Under the parties' construction of the MFJ (Assumption 1) Pacific could have been divested with 50 percent debt and its own cost of debt (9.7%), resulting in annual debt expenses of $592 million. Under California's construction of the MFJ (Assumption 2), Pacific could again have 50 percent debt, but with an average cost of debt of 9.2%, resulting in annual expenses of $562 million. However, Pacific's annual debt expenses under the Plan of Reorganization as approved by the District Court in the order appealed from (Assumption 3) will be only $540 million, some $22 million less than under California's own construction of the MFJ.[23] Under the proposal in California's Brief (p. 20 n.20), Pacific's debt expense would be lower still—$522 million (Assumption 4), but California assumes that it could insist on its reading of the debt cost provisions of the MFJ and also retain for Pacific a lower debt ratio than it acknowledges is provided by the MFJ. J.S. 19.

California cannot have it both ways. In the event the MFJ were construed to require that Pacific be divested with less than its own cost of debt, AT&T would withdraw that portion of the Plan providing Pacific a debt ratio lower than that required by the MFJ. In any event, however, because the Plan will result in a substantial improvement in Pacific's financial condition and leave Pacific better off than is required by any interpretation of the MFJ, it is apparent that California has neither legal nor practical grounds to complain that the Plan departs from the MFJ.

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[23]California acknowledges that the MFJ does not require Pacific to be divested with exactly the System average cost of debt (approximately 8.8%), which would treat it more favorably than several other BOCs. But even if Pacific were given debt costs of 8.8%, its annual debt expense (with the MFJ-prescribed debt ratio of 50%) would remain $540 million, leaving Pacific no better off than it will be divested under the Plan.

CONCLUSION

The District Court has shown that a trial court can expeditiously manage big antitrust cases and assure that the uncertainty that they create does not imperil vital national industries. The expedition of this appeal under the procedures Congress has established will enable the judicial system to continue to protect these public interests.

For the reasons stated, the appeals in this case should be decided by this Court before January 1, 1984. They are so lacking in merit that they should be affirmed summarily. This will remove the uncertainty that threatens the national telecommunications network while the Bell System completes the largest corporate reorganization in our nation's history.

Respectfully submitted,

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Nos. 83-737 and 83-738

In the Supreme Court of the United States

OCTOBER TERM, 1983

THE PEOPLE OF THE STATE OF CALIFORNIA and THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA, *Appellants,*

vs.

UNITED STATES OF AMERICA, AMERICAN TELEPHONE & TELEGRAPH COMPANY, ET AL., *Appellees.*

NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE, *Appellant,*

vs.

UNITED STATES OF AMERICA, AMERICAN TELEPHONE & TELEGRAPH COMPANY, ET AL., *Appellees.*

On Appeal from the United States District Court for the District of Columbia

MEMORANDUM IN SUPPORT OF JURISDICTIONAL STATEMENTS

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In the
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On Appeal from the United States District Court for the District of Columbia

MEMORANDUM IN SUPPORT OF JURISDICTIONAL STATEMENTS

The Oklahoma Corporation Commission ("Oklahoma") is the regulatory agency with jurisdiction over rates and practices of telephone companies in Oklahoma. Oklahoma was a party below in *United States* v. *AT&T*, 552 F.Supp.

131 (D. D.C. 1982), *aff'd mem. sub. nom. Maryland* v. *United States*, ___ U.S. ___, 103 S.Ct. 1240, 75 L.Ed.2d 472 (1983). Pursuant to Rlue 10.4 of this Court, Oklahoma is an Appellee. Oklahoma supports the position of Appellants, People of the State of California ("California") and New York State Department of Public Service ("New York"). This Court should note probable jurisdiction in these cases and set them for plenary review.

Oklahoma adopts the Jurisdictional Statement of California for the description of the Opinions Below, Jurisdiction, Statutory Provisions and Statement of the Case.

THE QUESTIONS ARE SUBSTANTIAL

As the District Court recognized, the AT&T divestiture is the "largest corporate reorganization in history" affecting "millions of employees and shareholders, the nation's telephone subscribers, AT&T's competitors, the telecommunications industry . . . and the responsibilities of federal and state regulatory bodies," App. at 353.

The immensity of this case is illuminated by the fact that the questions regarding station handling costs and complex inside wiring are not major issues in the case below — but represent over three *billion* dollars nationwide just for complex inside wiring, untold billion dollars for station handling costs; for Oklahoma, the investment represents $25 million for complex inside wiring and approximately $41 million for station handling costs. In any other case, these would be substantial numbers.

It is not just the numbers that make this case substantial.

The claimed error in this case is fundamentally one of disagreement over accounting. The experience of state telephone regulators was, in key respects, disregarded by a federal district court judge. Due to the press of time and certification in this case, this Court is the only forum in which the error can be corrected. This Court should allow the states a chance to present their case.

This case affects every telephone subscriber in America. It is a uniquely national case.

Understanding this case requires an understanding of some aspects of telephone engineering and accounting. These are fields coated with jargon. Oklahoma will try to cut through the complexity and present a simple explanation.

In the past, when you called the phone company for totally new phone service, the company would send a service agent who would string a wire from the nearest telephone pole to your home. In technical terms, this is the "drop wire" to the "protector". The protector is frequently on the outside of the residence and protects the phone system from damage from lightning. Then the service agent would wire the inside of the house from the protector to the service jack. This is "simple inside wiring". The service agent would install the telephone and test it. This is "station handling".

There are differences with business systems. If a business has several incoming lines or several telephones tied together with an intercom, it has "key system apparatus" or "private branch exchanges" ("PBXs"). Wiring these telephones together is more difficult and requires more time

of the service agent than residential-type wiring. It is called "complex intrasystem wiring".

In the past, the costs of all these "station connections", both residential and business, was accounted for in Account 232 of the FCC's Uniform System of Accounts. They were "capitalized", that is, treated as long-term investments on which the telephone companies earned a rate of return. This long-term recovery of these costs was chosen so as to keep as low as possible the initial cost of hooking up to the system. This encouraged widespread installation of telephones for everyone, or "universal service."

This long-term recovery caused problems because the sum of these station connections continued to grow. In 1979, the Bell system installed approximately 36 million telephones and removed approximately 31 million telephones, *Amendment of Uniform System of Accounts*, 85 F.C.C.2d 818, 824 (1981). All of the costs of these changes, including the labor charges, were booked to Account 232.

The FCC recognized this enormous capital outlay was a burden to the system. In 1981, it ordered all future inside wiring to be "expensed", that is, treated as an operating expense which allows for a far more rapid recovery of the costs. (The drop wire and protector continued to be capitalized.) The FCC authorized the accumulated inside station connection and inside wiring investment to be recovered over a ten-year amortization period.

In 1980, the FCC moved to deregulate "customer premises equipment" (CPE), which includes telephones, PBXs and key units. In the first order the Commission excluded inside wiring from the definition of CPE, *Amendment of*

Section 64.702 of The Commission's Rules and Regulations (Second Computer Inquiry) Docket No. 20828, 77 F.C.C.2d 384, 447, 35 P.U.R.4th 143, 205 n.57 (1980). In a subsequent order, the FCC stated that the issue of inside wiring "was not addressed" in earlier proceedings, and was specifically reserved for a later proceeding, 84 F.C.C.2d 50, 69, 39 P.U.R.4th 319, 341 (1980).

On January 8, 1982, the parties in the AT&T antitrust case filed a stipulated "Modification of Final Judgment". On August 11, 1982, Judge Greene filed his opinion in that case (App. 1-172), and the companion Modification of Final Judgment was filed August 24, 1982 (App. 173-190). The Modification of Final Judgment assigned to AT&T "all facilities, personnel and books of account . . . relating to . . . the provision of customer premises equipment to the public." (MFJ, §§I(A)(2), I(A)(4); App. at 174-175.) "Customer premises equipment" was defined as "equipment employed on the premises of a person . . . to originate, route or terminate telecommunications," not including "equipment used to multiplex, maintain or terminate access lines." (MFJ, §IV(E); App. at 177.)

On December 16, 1982, AT&T filed a Proposed Plan of Reorganization. That plan assigned all of the customer premises equipment to AT&T, but all of the embedded cost of installing that equipment (Account 232) to the proposed new regional Bell Operating Companies (BOCs). Several state commissions and the National Association of Regulatory Utility Commissioners protested the assignment of the inside wiring and station handling costs to the BOCs.

On February 28, 1983, this Court affirmed the Modified Final Judgment, *Maryland* v. *United States*, ___ U.S. ___,

103 S.Ct. 1240, 75 L.Ed.2d 472 (1983). The treatment of the issues relating to station connections were still being litigated. On March 14, 1983, AT&T filed its "Response to Objections to its Proposed Plan of Reorganization". It claimed there was "no way" to determine station handling costs (p. 154) and claimed "no distinction" could be made for complex inside wiring (pp. 154-155). Even AT&T noted, however, that New York was already charging separate charges for inside wire (p. 163, n.**).

State commissions protested that the various elements of Account 232 *could be* and *had been* segregated (Comments, N.Y. Dept. Pub. Serv. at 11; Further Comments, Calif. Pub. Util. Com'n at 24; Reply Comments, CPUC, at 26).

The District Court conditionally approved the Plan of Reorganization on July 8, 1983 (App. 195-330). There was *no* mention of the complex intrasystem wiring and station handling claims. On July 28, 1983, the District Court dealt with an AT&T Motion for Partial Reconsideration. It dismissed Account 232 claims along with "patent licensing" claims in a footnote (App. at 339, n.18).

The modified Plan of Reorganization was approved by the District Court on August 5, 1983. In the memorandum approving the Plan, the court described AT&T ownership of inside wiring as creating a "bottle-neck". The court was persuaded by AT&T that "there is no practical way to separate" the various costs (App. at 344). The District Court did acknowledge that "a theoretical case could be made" that some portion of Account 232 should follow the embedded customer's premises equipment.

The case is more than theoretical. The states had demonstrated that AT&T's costs *could* be separated in a reasonable manner. The District Court should have deferred to the experience of the state regulatory agencies, and conditioned approval of the Plan on the appropriate allocation of these costs to AT&T.

District courts should have a "scrupulous regard" for state public service commissions, *Alabama Public Service Com'n* v. *Southern Railway Co.*, 341 U.S. 341, 349 (1951). The ratemaking process is "essentially empiric. The stuff of the process is fluid and changing . . ." *Board of Trade* v. *United States*, 314 U.S. 534, 546 (1942). It is not an area well suited for court determination. The District Court should have granted great deference to the experience of state regulators. If state regulators say an account can be meaningfully divided, the courts should recognize that it probably can be divided. This Court has recognized that such disputes are:

> for the regulatory commission and not for the courts. We repeat that for a court to upset an accounting order it must be 'so entirely at odds with fundamental principles of correct accounting' . . . as to be the expression of a whim rather than an exercise of judgment. — *United States* v. *New York Telephone*, 326 U.S. 638, 655 (1946)

The state regulatory commissions have established reasonable accounting distinctions for separation of Account 232. The Federal Communications Commission has detariffed intrasystem wiring installed in the future, *In the Matter of Modifications to the Uniform System of Accounts for Class A and Class B Telephone Companies*, CC Docket No.

82-681, Order November 2, 1983. The regulatory judgment is that the purchaser of the customer premises equipment should pay for the costs of installing that equipment. The District Court erred in placing the equipment with AT&T, and the installation costs with the Bell Operating Companies.

The District Court contradicted its own prior order. The District Court should have recognized that station handling and complex intrasystem wiring were part of the "books of account . . . relating to . . . the provision of customer premises equipment to the public" (MFJ, §§I(A)(2), I(A)(4); App. at 174-175). The District Court should have corrected AT&T when it assigned some accounts of the wiring used "to originate, route and terminate telecommunications" (MFJ, §IV(E); App. at 177) to the Bell Operating Companies.

CONCLUSION

The District Court contradicted the judgment of experienced state regulatory commissions. The District Court contradicted equitable principles that the person receiving the benefit (*i.e.*, CPE) should pay the costs associated with that benefit. If this Court does not correct the contradictions, every telephone ratepayer in America will be required to pay their local Bell companies for the accrued cost of installing equipment that AT&T now owns. This Court is now the only chance to rectify that error. This Court should note probable jurisdiction in the appeals filed by California and New York.

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No. 83-738

IN THE

Supreme Court of the United States

October Term, 1983

NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE,

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UNITED STATES OF AMERICA, AMERICAN TELEPHONE AND TELEGRAPH COMPANY, *et al.*,

Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF OPPOSING MOTIONS TO AFFIRM

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[1] This brief does not contain references to materials required to be listed in a Table of Authorities under Rule 33.5(b).

IN THE

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October Term, 1983

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NEW YORK STATE DEPARTMENT OF PUBLIC SERVICE,

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Appellees.

ON APPEAL FROM THE UNITED STATES DISTRICT COURT FOR THE DISTRICT OF COLUMBIA

BRIEF OPPOSING MOTIONS TO AFFIRM

Preliminary Statement

The New York State Department of Public Service seeks review of a United States District Court decision approving AT&T's plan for reorganizing the Bell System. The basis of our appeal is that the plan of reorganization, as approved, violates the Court's "modification of final judgment" (MFJ) by allowing AT&T to retain customer premises equipment while

transferring the cost of installing, testing and handling that equipment to the newly divested Bell Operating Companies. Although the MFJ requires AT&T to accept all books of account relating to customer premises equipment (J.A. 174), Judge Greene has allowed AT&T to avoid its responsibility to assume "station handling costs." His decision is grounded on a fundamental mistake of fact; that is, AT&T's incorrect contention that it is impossible to develop a reasonable estimate of these costs.

By motion dated November 22, 1983, AT&T has sought an expeditious affirmation of Judge Greene's decision on the grounds that this appeal "implicates the heart of the reorganization" (page 8) and that New York's objection to the BOCs' retention of station handling costs is frivolous.

I. AT&T's motion for summary treatment of this appeal should be denied.

As indicated in New York's Jurisdictional Statement, the station handling costs associated with the customer premises equipment which AT&T will retain after reorganization are at least $106 million and arguably as high as $600 million in New York State alone (New York Jurisdictional Statement, pg. 7). AT&T has managed to avoid its responsibility under the MFJ to assume these costs by misrepresenting the facts. That is, although New York Telephone Company and Pacific Telephone Company have both presented a *minimum* quantification of station handling costs within Account 232, AT&T informed Judge Greene that station handling costs could not be quantified and therefore could not be transferred to AT&T. It is therefore understandable that AT&T would now seek to minimize judicial review of this enormously important issue.

In support of its contention that Judge Greene's decision should be summarily affirmed, AT&T claims that the station handling issue "implicates the heart of reorganization". However, in attempting to support its contention, AT&T has discussed only the significance of complex wire and debt allocations—questions raised by the California Commission.

The pendency of this appeal appears to have had no effect on the trading of the common stock of AT&T and the newly divested regional holding companies. And there clearly is no basis for even an argument that careful review of the station handling issue would in any way jeopardize the mechanics of reorganization.

AT&T's contention that a correction of Judge Greene's error on this issue could lead it "to reconsider these and other provisions of the MFJ and plan, because any significant change in the plan could destroy the careful balance the MFJ was intended to achieve" is at best disingenuous. As AT&T's own statement of the case acknowledges, its plan of reorganization has already undergone 41 amendments. If it now reflects a "careful balancing" of shareholder/customer interests, what did it represent when AT&T first submitted it?

There is no question that the station handling issue now before this Court involves well over a billion dollars in costs and far-reaching policy issues. AT&T's motion for summary affirmance should be denied.

II. AT&T's description of the station handling issue is simply incorrect.

Station handling costs are the capitalized labor expenditures related to the handling, installation and testing of customer premises equipment prior to January 1, 1981. There is no question that these costs, by definition, relate to customer premises equipment under the terms of the decree (MFJ, Section I (A)(2); J.A. 174). Indeed, Judge Greene recognized this fact when he acknowledged the "theoretical case" for assigning these costs to AT&T (J.A. 344). The only questions on appeal, therefore, are (1) whether AT&T misled Judge Greene into believing that "there is no practical way to separate out the various handling costs" (*Id.*), and (2) whether the court's utter failure to assign *any* station handling costs to AT&T was an abuse of discretion in light of the clear language of the MFJ requiring the transfer of CPE-related costs to AT&T.

AT&T has attempted to blur these questions by offering a series of claims which, frankly, misrepresent the facts. Perhaps the most useful method of replying to AT&T's arguments is to answer them *seriatim* as they appear at pages 16 through 21 of its brief.

First, AT&T claims that New York has acknowledged that the BOCs were properly assigned complex and simple inside wiring (AT&T, page 16). AT&T offers no citation to New York's Jurisdictional Statement because, indeed, New York made no such statement. In fact, we objected vehemently to this assignment before Judge Greene but decided to limit our appeal to the station handling issue.

Second, AT&T characterizes New York's description of station handling costs as the costs incurred for service

men to "perform the function of connecting the inside wire to telephone handsets." Again, AT&T offers no reference to our jurisdictional statement because it has misrepresented New York's position. Station handling costs do not relate to the connection of inside wire to telephone handsets but, rather, to the handling and testing of customer premises' equipment before it is even installed, as well as its installation.

Third, AT&T claims that station handling is simply "the last act in establishing a *working station connection*" (Emphasis added, AT&T, p. 17). Its statement could not be further from the truth. Indeed, customers in the past with existing phones which they wished to replace or those adding additional station sets (extensions), clearly had "working station connections", but imposed additional station handling costs on their BOCs when they ordered new CPE. Station handling costs relate to the customer premises equipment which AT&T will receive from its BOCs—not to the provision of local exchange service.

The company's fourth argument repeats its erroneous contention to Judge Greene that there is no way to determine station handling costs and that, therefore, it should be assigned none of these costs (AT&T, p. 17). As indicated in New York's Jurisdictional Statement, AT&T's contention belies the action of its own subsidiaries—New York Telephone and Pacific Telephone.

In our Jurisdictional Statement, New York pointed out that "station handling costs can be identified with as much certainty as a myriad of other assets and costs being transferred in the divestiture proceeding" (New York, p. 6). AT&T challenges this statement by arguing that all other assets are being transferred in accordance with precise recordkeeping (AT&T, p. 18, footnote 12).

The plan of reorganization's allocation of depreciation reserves, income reserves and off-book items all entail a prorating of transferred assets to total book accounts.

AT&T's next claim is that station handling investment is not a physical asset and therefore its assignment is irrelevant to AT&T's prices and post-divestiture competition (AT&T, pages 18-19). This position defies common sense. If AT&T is assigned station handling costs (which, again, its competitors clearly incur), it must either increase its prices or decrease its profits.

AT&T argues that requiring it to assume the station handling costs related to the CPE which it will receive would "renege on the regulatory obligation to permit the Bell System's three million shareholders to recover their capital" (page 21). AT&T is conveniently ignoring the fact that Bell System shareholders own the Bell operating companies as well as AT&T. The Court's correction of Judge Greene's error would simply require AT&T's shareholders to shoulder the costs of handling and testing AT&T's equipment.

Finally, AT&T implies that the capitalization of station handling costs (to further Congress's goal of universal service) was inconsistent with accepted accounting principles (AT&T, page 20). By no stretch of the imagination can it be said that capitalizing costs relating to the handling of capital assets (CPE) is in any way improper.

AT&T's position boils down to the claim that newly divested Bell operating companies should be forced to assume costs relating to AT&T's equipment because AT&T was unable to estimate these costs. Judge Greene's acceptance of this claim was, again, based on a fundamental mistake of fact and otherwise an abuse of discretion.

Conclusion

Based on the foregoing, the Court should note probable jurisdiction of this appeal. It should deny AT&T's motion for summary affirmance and permit full briefing and argument of the "station handling costs" issue.

Respectfully submitted,

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